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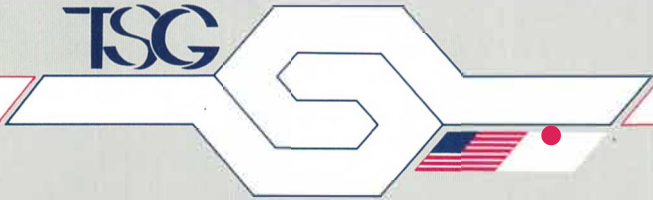
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TSG



Progress Report: 1984

u.s. Japan Trade Study Group

September 1984

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INTRODUCTION

The U.S.-Japan Trade Study Group (TSG) is a bilateral group, consisting mainly of Americans from the U.S. business community in Tokyo and Japanese businessmen, all acting in an individual capacity. Their link in common is a dedication to free trade.

TSG's purpose is to promote the growth of trade and investment between the two countries. Its primary approach is to examine apparent problems of access to the Japanese market, to establish the facts as fully as possible in these cases, and to recommend initiatives or corrective action that would help solve the trade and investment problems found to exist.

TSG's focus on barriers in Japan does not imply that no such barriers exist in the United States. It stems from the fact that TSG's members, all of whom live and work in Japan, are in first-hand contact with those who perceive hindrances to market access in their working experience. We recognize that problems also exist for Japanese and other foreign firms operating in the U.S. market, and it is hoped that a sister organization to TSG will soon be formed in the United States to work with us in broadening our coverage of market access issues.

That TSG has been active in Japan since 1977, in the absence of a sister organization in the United States, also reflects the fact that bilateral trade in recent years has been heavily in Japan's favor - to an extent that has been politically difficult to accept in the United States. The risk has grown that artificial barriers may be imposed in response, an outcome that would be strongly against the long-term interest of both countries and of the world at large. Finding and removing barriers in Japan as one means of increasing the flow of goods, services and investment in the other direction - from the United States to Japan - thus appears to call for some priority of attention.

This report documents in some detail the substantial progress made in removing trade and investment barriers since TSG's previous progress report in 1980. It also spells out the problems that remain - some affecting specific industries, others having a broad impact on trade or investment generally - and recommends constructive steps that can assist in their solution.

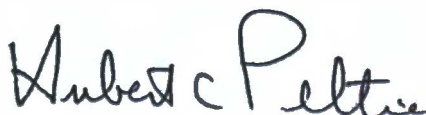
Progress is a matter of continuing change, and in some sectors the pace of progress in resolving questions of Japanese market access is quickening. This report describes the situation as of mid-1984. The reader should bear in mind that some of the barriers described may have been lowered or removed by the time of reading.

TSG hopes that the report will assist all those in both countries who are seeking to end trade friction and to promote free trade. In particular, it is our desire to contribute facts for informed discussion of the issues and proposals that will stimulate effective action on those issues.

The assistance and information provided by both governments during the preparation of the report are acknowledged with thanks. The opinions and recommendations found in the report, however, are solely those of TSG.

It is impossible to mention individually all the people who contributed to the writing of this report. But we want to express to them our deep appreciation for their work. The report is the embodiment of their experiences, their insights, and their dedication to improved bilateral relations. We also want to express our gratitude to the members of the Editorial Committee who worked so long and so hard to prepare the final draft for publication: Joan V. Allen, Lawrence Bruser, Keiji Miyakawa, Tsugio Kusajima, and Robert Mcilroy.

All of the members of TSG express their deep appreciation to Michael K. McAbee, Asia Correspondent of *Industry Week*. He has worked tirelessly over many months to convert our crude drafts of material into a properly edited, well-formatted manuscript. His advice on style, technical matters and general content of the report has been invaluable. We give him a well deserved *domo arigato gozaimashita*.



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OVERVIEW

Progress Report: 1984 has been prepared by a number of TSG committees and specialists, working in their respective industrial and professional areas. The trade and investment issues examined are as various as the industries involved. Yet two broad conclusions have emerged. One is that Japan is making substantial efforts and progress in removing trade barriers — more so than many Americans realize. The other is that Japan's market-opening efforts have left many important problems unresolved — more so than many Japanese acknowledge.

A fact that emerges again and again in the reports that follow is that great progress has been made and continues to be made in resolving bilateral trade frictions and removing causes of complaint. The U.S. and Japanese governments are conferring with increasing frequency and at more levels in efforts to find common ground for solving present problems and avoiding potential problems. Increasingly, constructive dialogue between the Japanese government and the American business community is assisting these efforts.

Yet despite the progress that has been achieved, a great number of barriers remain. They cover a wide range of policies, laws, regulations, administrative practices, and business practices. In addition to the specific problems identified, a number of underlying themes recur in many of the sectoral reports. They may be summarized as follows:

- 1) **Transparency:** Many trade frictions derive from the fact that Japanese policies, laws, and regulations are not formulated in public. TSG believes that greater transparency in these processes would resolve real problems as well as remove unfounded suspicions.

- 2) **Administrative guidance:** Many frictions also arise as a result of the broad informal and discretionary authority that Japanese government agencies have in regulating or influencing business. TSG believes that such problems could be resolved if this authority were exercised in a more clear and visible manner.

- 3) **Implementation:** In many cases greater progress depends on faithful and effective follow-through by working-level administrators of policy decisions made by the Cabinet.

- 4) **Multilateral solutions:** In several cases TSG feels that the problems identified are international in scope and thus may require the establishment of international rules or agreements if they are to be completely resolved.

It seems clear that these underlying themes must be addressed if lasting solutions to economic conflicts between Japan and the United States are to be reached.

Highlights of each chapter of *Progress Report: 1984* are summarized below. They outline progress made and major problems remaining in each sector. TSG's recommendations are too numerous to be summarized here and are therefore made in the main text.

U.S. and Japanese Trade Barriers: A General Comparison

Comparison of the extent to which various kinds of barriers to trade and inward direct investment exist in the two countries provides useful perspective in measuring the progress made to date in Japan's market-opening efforts.

Average tariff rates of both countries will be little different once cuts decided in the Tokyo Round multilateral trade negotiations are fully implemented in 1987. For some goods, however, both countries retain high tariffs (25% or higher) regarded by the other as a substantial impediment to trade. Both governments also resort to import quotas as a means of controlling trade in certain goods, itemized in this report.

In the United States, anti-dumping orders and countervailing duty orders are in effect against a range of Japanese goods determined by U.S. government investigation to have been priced in the United States at less than fair value or at prices reflecting Japanese subsidies and injuring a U.S. industry thereby. There are no Japanese anti-dumping or countervailing duty orders in effect against U.S. products.

In the United States, "Buy American" laws in some states require state agencies to purchase steel, construction services and the like from American-owned suppliers only. These laws, however undesirable, are at least specific and are administered in a transparent manner. Japanese government procurement policies tend to be non-transparent and sometimes contradict in practice the government's agreements in principle. Procurement by Nippon Telegraph and Telephone Public Corporation, for example, ignored for almost 30 years until 1981 a treaty provision that purchasing by such government-owned enterprises should be based solely on commer-

cial considerations and should afford U.S. suppliers adequate opportunity to compete.

Direct investment by foreigners is generally unrestricted in the United States. The worldwide unitary method by which some states tax corporate income, however, is viewed in Japan as a substantial disincentive to investment. Japan, meanwhile, continues to require prior notice of all inward direct investments. American sources also point out that some Japanese industries ostensibly open to foreign direct investment are in fact closed due to administrative guidance by the ministries involved. Examples are underwriting and auditing (supervised by the Ministry of Finance) and warehousing, stevedoring and trucking (Ministry of Transport).

Generic Problems

Some non-tariff barriers may affect only a few goods or services, but others obstruct trade over a broad front. Such NTBs - in customs valuation methods and clearance procedures or government procurement policies, for example - are generic trade problems with far-reaching effects.

Removing generic NTBs is a major aim of the Tokyo Round GATT Codes drafted in 1979, all of which were adopted by Japan. Four of them - the Standards Code, Government Procurement Code, Customs Valuation Code and Import Licensing Code - together cover many of the generic NTBs that foreign firms had perceived in Japan. Great progress has been made in eliminating barriers within the scope of these Codes.

1. Standards Code

Japan has conformed well with this Code - drawing upon international standards when drafting or revising technical regulations, replacing design restrictions with performance tests in several standards, giving prior notice of intent to draft or revise standards, and taking foreign comment into account in standards-drafting. Overseas firms have gained access to Japanese certification systems and marks of approval. However, Japan still does not accept such certifications issued in other countries. A continuing problem outside Code jurisdiction is the lack of transparency in Japan's standards-writing process. To liberalize the system to European or U.S. levels of openness requires greater foreign participation on the industry association panels that prepare preliminary drafts of Japanese standards than Japan has accepted so far.

2. Customs Valuation Code

One of the few remaining problems with customs valuation is Japan's method of assessing the value of goods imported in "related-company" transactions. A substantial volume of Japanese imports move from offshore offices to domestic offices of the same trading firm. The uplift in asses-

sed value of such goods for customs purposes bears heavily on such traders.

A major step toward ending widespread complaints that identical goods are assigned different customs classifications at various Japanese ports was taken in 1983, whereby the Ministry of Finance on request will issue advance rulings on classifications that will be honored at all ports of entry. Much has also been done to provide means for fair and impartial hearings of grievances regarding customs valuation and classification, in conformity with the Code.

Cumbersome clearance procedures are today's leading problem in entry of goods into Japan. The basis for Japanese regulation is that trade is *prohibited* until trade officials grant permits to "clear" the "impounded" goods. The unnecessary delays that result discourage importers and impair trade as surely as would high tariffs. To improve entry administration to a level of openness and efficiency befitting Japan's leading role in world trade, TSG recommends a number of specific amendments to the Customs Law and the Cabinet Order for its enforcement, and certain changes in practice that could readily be made under the existing Law and Cabinet Order. (TSG realizes that, in some cases, means may exist to make such changes short of amending the law itself.)

3. Import Licensing Code

Japan has taken no substantive action to comply with this Code. The Foreign Exchange and Foreign Trade Control Law as amended in 1979 contains excellent provisions regarding import licensing that should receive prompt implementation.

Import restrictions seem through interpretation to be added or deleted at the discretion of Japanese trade administrators. The published list of items under import quota, for example, has often been expanded by administrative interpretation. Positive action should be taken at the highest level of government to prevent lesser authorities from instituting practices that impede the flow of trade.

Allocation of import quotas is far from transparent. Since a quota allocation is a privilege given by the government to a private entity, all applicants should be able to compete on an equal footing. Yet actual quotas currently held by trading firms and others are not now made public. An open system such as auctioning of licenses to obtain allocations - suggested by the Japan-U.S. Businessmen's Conference - would either confirm or end suspicions that allocations are being held by Japanese entities which are not using them.

4. Government Procurement Code

Japan has generally conformed to the transparency requirements of this Code. The greatest difficulties for potential overseas suppliers stem from Japan's restrictive interpretations of points where the Code allows the tendering government some latitude. For example, the 30-day *minimum*

period of notice of procurement set by the Code is the *maximum* allowed by most Japanese government agencies. Also, many competent foreign suppliers are eliminated from competition by the practice of assigning "grades" to suppliers on the basis of their financial strength.

The Code covers procurement by "agencies and entities" of the Japanese government, including Nippon Telegraph and Telephone Public Corp. (N'IT), which spends some \$2.5 billion a year for procurement. However, NTF purchases of "public telecommunications equipment" is specifically excluded from Code coverage. For this reason, a separately negotiated bilateral pact, the U.S./Japan Agreement on Telecommunications Procurement, came into force simultaneously with the Code in Japan. The Agreement was renewed in January 1984 for a second three-year term, with new provisions that should improve foreign access to NTF procurement. Whether it will be binding on NIT after its expected reorganization as a semi-private company in 1985 is uncertain. NTF procurement is discussed from another perspective in Chapter 5: High Technology.

S. Market-Opening Measures

Another approach to trade troubleshooting by the Japanese government was signaled in 1982 by the release at Cabinet level of the first of a series of "packages" of market-opening measures that have ranged from tariff reductions and changes in regulations to legislative proposals for amending restrictive features of Japanese laws.

The stated aim of these packages, five of which have issued as of mid-1984, has been to increase imports of manufactured goods and some agricultural products and to bring trade administration closer to international norms. Results to date have been mixed. Key points of the five packages are discussed and their effectiveness evaluated.

6. Office of Trade Ombudsman

As a means of monitoring compliance with the market-opening packages, the first of them provided for a new, government-wide channel for bringing grievances. The Office of Trade Ombudsman (OTO) was established to provide both a forum for NTB complaints and liaison among government agencies with the goal of prompt handling and clear resolution of grievances by the proper agency. OTO has been a valuable tool for tracing trade problems to their root. TSG estimates that perhaps two-thirds of the complaints brought to date have been resolved to the complainant's satisfaction. But some firms have been reluctant to bring grievances to OTO for fear of retaliation or of disturbing their established relations with the regulatory agency involved.

OTO has good potential for resolving trade problems, but needs more authority to negotiate settlements. In April 1984, OTO's charter was broadened to include the handling

of grievances related to foreign direct investment in Japan. TSG recommends that its charter be further broadened to include grievances related to trade in services.

Problems in Specific Product Areas

TSG has investigated trade problems specific respectively to eight groups of manufactured or processed goods. In most cases there has been significant progress in removing Japanese trade barriers. Substantial problems still face U.S. suppliers, however. In product areas other than those reported below, either there are no significant trade barriers or the firms encountering such problems have not come forward with them.

1. Automobiles

For witnessed testing and certification, the Ministry of Transport (MOT) has begun accepting sample vehicles of a representative model within a family of models, replacing the previous requirement for sample vehicles of every model in the family. This reduces the total workload of certification. For type designation, MOT now accepts durability data instead of requiring test vehicles for durability trials in Japan, and is accepting data obtained abroad by test procedures considered nearly equal to the corresponding Japanese procedures. MOT has agreed to informal discussions of U.S. proposals to simplify homologation requirements.

Still a barrier to U.S. automobile exports to Japan, U.S. automakers say, are two aspects of Japan's commodity tax. It is higher for vehicles of sizes that comprise most U.S. vehicle exports. Also, it is assessed on CIF value of imported vehicles, creating a significant cost disadvantage since vehicles manufactured in Japan are taxed at the cheaper ex-factory price. The Japanese response is that the higher rate of commodity tax for larger cars reflects the progressive taxation system in Japan, and is not intended to discriminate against imports.

2. Pharmaceuticals

Good progress has been made by the Ministry of Health and Welfare (MHW) in reducing duplicative testing requirements and simplifying other procedures in new drug registration. For example, shorter-term stability test data can now be filed to support a new drug application; the required long-term testing can continue in parallel with processing of the application, thus shortening the time needed for registration. Only one firm among co-developers of a new drug need carry out the long-term stability tests, which were previously required of all. MHW will now accept results of preclinical studies conducted abroad under Good Laboratory Practices (GLP) standards, even if they are not part of the data filed for product approval in the other country. MHW has proposed new guidelines, quite close to those in the United States and

Europe, to harmonize preclinical study requirements with those abroad.

A continuing problem involves transfer of pharmaceutical manufacturing licenses, which embody product ownership rights, from one firm to another in Japan. Such transfer is allowed at government discretion, on a case-by-case basis under restrictive conditions. Until 1975, when foreign drug firms were first allowed to establish majority- or wholly-owned manufacturing operations in Japan, many licensed their products to Japanese drug companies. Now, most foreign firms have set up their own manufacturing subsidiaries in Japan. Their economic feasibility often depends on transfer of manufacturing rights for the foreign firm's established product line from the former Japanese licensee to the subsidiary. In practice, MHW allows transfer only if the former licensee fully consents. Transfer of recently registered products is almost impossible. And there are no clear-cut, published guidelines for MHW's handling of transfer requests.

Another matter of concern is that in such matters as application for new drug registration in Japan the entire review process is conducted in private - in contrast to the public presentations and response to questions allowed drug companies in most Western countries. This problem is compounded by the lack of an open forum for appeal of regulatory decisions regarding pharmaceutical administration.

3. Medical Supplies and Equipment

MHW has opened channels to foreign firms operating in Japan and has demonstrated its desire to communicate and to hear their proposals on regulatory issues affecting medical supplies and equipment. Among recent regulatory changes that eliminated problems for foreign suppliers, MHW has begun accepting overseas non-clinical test results (for electrical safety and the like) for new product registration. A simple, speedy procedure for transfer of product import licenses from one importer to another in Japan has been adopted, and approval of partial changes in previously approved products has been simplified. MHW is considering acceptance of foreign clinical test data for medical devices if racial differences among patients are irrelevant, and procedural changes to simplify and shorten new product registration.

Two key issues remain unresolved. First, MHW requires that an application for a partial change be filed if an overseas manufacturer of medical devices wishes to supply Japan from a plant in a country other than that from which the item is currently being shipped to Japan - even though product and manufacturing process are identical in the two plants.

Second, MHW regards *in vitro* diagnostic reagents as pharmaceuticals for registration purposes, despite the fact that these reagents are chemicals used in laboratory tests and do not come into contact with the patient. Much of the costly,

time-consuming testing appropriate for pharmaceuticals is irrelevant for *in vitro* reagents. MHW has, however, shortened the approval time.

4. Cosmetics

Progress is evident in removing trade barriers in this field. Registered products being imported are no longer subject to lengthy MHW testing as they enter Japan. As yet unregistered products may now be used in consumer preference testing in Japan, and larger quantities of unregistered-product samples can be imported. U.S. animal testing need no longer be duplicated in Japan, and some product registration procedures have been eliminated or simplified. MHW has established an advisory subcommittee with foreign participation, giving U.S. firms some access to the standards-setting process for cosmetics.

Slowness of product registration, however, is a continuing source of trade friction. And a major issue that MHW must face in the future is the question of broadening efficacy claims for cosmetic products. Despite repeated revision, the 1960 law under which the industry is regulated does not reflect technological progress in recent years. As a result, product differentiation is difficult in Japan - especially so for foreign firms now attempting to enter the Japanese market.

5. Agricultural Chemicals

U.S. chemical companies have been concerned about a 1978 directive of the Ministry of Agriculture, Forestry and Fisheries (MAFF) that almost all toxicology studies (safety testing) of these products be conducted in public laboratories in Japan. Among other problems, this would mean expensive duplication of testing done abroad and would slow product development due in part to the insufficient number of public toxicology laboratories in Japan.

MAFF has decided in a spirit of cooperation not to implement its directive, on the grounds that it was widely viewed as a trade barrier. Meanwhile, MAFF is drafting Good Laboratory Practices (OLP) standards as well as new guidelines for toxicology studies. TSO believes that the final combination of guidelines and OLP standards will result in rules acceptable to all parties.

6. Forest Products

Recent events and trends that have removed or reduced trade barriers against U.S. forest product exports to Japan include revision of Japan Agricultural Standards (JAS) for softwood plywood. Annual meetings among the U.S. and Japanese governments and the forest products industries of the two countries are now being held to exchange views, and a continuing dialogue has developed between the Japan Paper Association and the American Paper Institute. There is also good evidence of improved market promotion by U.S. industry associations.

A continuing problem is what the U.S. side regards as formidably high tariff rates for several imported products, such as both softwood plywood and veneer (15% rate) and particleboard (12%).

7. Tobacco Products

Progress is visible in moving toward eventual elimination of discriminatory barriers in Japan against imported tobacco products. The number of licensed retail outlets allowed to sell imported brands was substantially increased in 1983, and all outlets will be allowed to sell imports as early as April 1985. The ceiling on advertising outlays (based upon each firm's sales in the previous fiscal year) has been raised, and several lesser discriminatory practices have been dropped or eased.

Legislation enacted by the Japanese Diet in August 1984 will end the system under which the Japan Tobacco and Salt Public Corp. (JTS) regulates the promotion and marketing of all brands — imports as well as its own. JTS will continue to be the sole manufacturer of tobacco products in Japan, though regulatory power will pass from JTS to the Ministry of Finance.

This legislation has potential for liberalizing the import and wholesaling of tobacco products. But it leaves intact the present uniform retail pricing system, including the artificial premium at which foreign brands must be sold. It also makes little progress regarding the disadvantage imposed on imports. Japan's 56% *ad valorem* tax applies to all foreign-brand and first-class cigarettes, but for imported brands it is applied to the sum of CIF value *plus* the 20% import duty. The United States taxes on a unit (cents-per-cigarette) basis — an approach that avoids the "tax on tax" problem faced by imports in Japan. Japanese members of TSG note, however, that it is acceptable international practice to consider CIF cost of imports *plus* tariff as equivalent to ex-factory price of goods for domestic tax assessment. They add that Japanese firms also encounter "tax on tax" problems, such as assessment of state sales taxes, in the United States.

8. Food Products

Beginning in 1982, Japanese tariff rates have been lowered for a number of food products on four occasions as part of successive packages of market-opening measures, and quota ceilings for some food products have been raised.

Several hundred individual food products are still under quota control, however. For some of them, TSG believes, early liberalization is feasible. Examples are cited of products which if freed would benefit U.S. exports without serious harm to Japanese agriculture.

A leading problem of Japan's quota administration is its non-transparency. It is difficult for prospective foreign suppliers of quota items to identify the holders of import licenses for those items. Criteria for award of quota alloca-

tions are not always followed. As a result, a portion of the quantities allowed under a quota are not actually imported in many cases, due to the marketing difficulties which the allocation system poses for the final user in Japan. An analysis is presented of the typical operation of the quota system and the problems it raises for foreign suppliers, Japanese importers and final users.

Problems in Service Industries

Service businesses are Japan's fastest-growing industrial sector. They are also the sector in which U.S. companies, based in the world's most service-oriented economy, often claim the lead in innovation and competitiveness. The nature and extent of Japanese trade barriers varies widely among the service industries, six of which are considered below.

1. Insurance

U.S. insurance firms enjoy in general the same freedom of operation in Japan as do domestic firms. To date, the Ministry of Finance (MOF) has licensed 18 foreign life insurance firms and 39 non-life insurance firms to operate in Japan. No new domestic life insurance firm has been licensed in the past 40 years, and only one domestic non-life firm.

For U.S. insurers, however, the types of coverage offered and the cost of policies have long been the variables on which their competitiveness is based. The internal balance of under-writing, actuarial and marketing disciplines which generates their products are conditioned by these variables. In Japan, contracts and rates for products are standardized industry-wide, so that factors other than coverage and cost become the determinants in insurance purchases. The Japanese system guarantees a relatively standard product that protects both insured and insurer. The market's stability enhances management and control, and consumers enjoy the protection of this supervision. On the other hand, the dynamics of more open competition in coverage and cost possible in the United States results in flexibility of product design and pricing that responds closely to the varying needs of consumers.

Neither Japanese nor U.S. insurers insist upon the ultimate application of either system, but U.S. firms believe that regulatory moves in the direction of allowing more flexibility in coverage and cost of insurance in Japan would best maintain the financial health of the industry and best meet the needs of insurance purchasers.

2. Banking

Japan's financial system is undergoing rapid structural changes, which are providing some benefits to foreign banks.

Recent moves toward liberalizing the financial market include the elimination of the real-demand requirement for forward foreign exchange transactions; elimination of all limits on converting foreign currencies into yen for purposes of domestic currency funding; and reduction of the minimum value and maturity of negotiable certificates of deposit, making this source of bank funding more attractive to buyers. The Ministry of Finance (MOF) has lifted quotas and other restrictions on overseas yen lending by both Japanese and foreign banks, and foreign banks may now lead manage yen loan syndications.

In coming months, foreign investment banking firms will be able to lead/co-lead manage Euroyen issues for Japanese resident or non-resident issuers, and qualified foreign banks will be able to participate in the same trust banking activities in which Japanese trust banks now engage. MOF has also indicated its intent to establish guidelines for creation of a yen-denominated bankers' acceptances market in Japan by the end of 1984. Foreign local governments, multilateral organizations and non-Japanese corporations, moreover, will shortly be authorized to issue unsecured yen bonds in the Euromarket.

Several problems remain in banking regulation where further progress would be welcome. One is the continuation of foreign exchange trading limits. All banks are restricted in the amount of overnight exposure (overbought or oversold) in non-yen currencies that they can hold. The restriction varies from bank to bank. Now that the real-demand requirement for foreign exchange transactions has been removed, many banks feel their limits are too restrictive.

Another problem is money market interest rates. Foreign banks in Japan have traditionally priced their short-term loans in relation to Japan's bills discount rates. But these rates, in the opinion of foreign banks, are not determined by market demand, nor do they reflect the amount (or lack) of liquidity in the market. Thus the bills discount rate has become steadily less relevant as a means of determining the base cost of short-term yen lending for foreign banks. Japanese banks, however, perceive that differences between these rates and money market rates are only temporary; they therefore believe that bills discount rates do reflect money market rates.

The Banking Law allows a foreign bank to purchase a Japanese bank or other financial institution (except a securities firm), and an established application procedure exists. Yet TSG is unaware of any applications being filed by foreign banks. This seems to be due to the perception that owners of Japanese banks are reluctant to sell a controlling interest to another institution, Japanese or foreign.

In looking at banking in Japan and the structural changes now in progress, it should be noted that there are fundamental differences between the financial systems of Japan and the United States. One is that, in Japan, most

deposit rates are not sensitive to market forces. Another is the concern shown by Japanese authorities about the possible impact on weaker financial institutions of increased competition resulting from liberalization. It should be understood that these differences stem from historical developments in the two countries, and that positive steps are being taken in Japan to permit greater influence of market forces.

3. Legal Services

Japan is effectively closed to foreign lawyers in private practice. By contrast, foreign lawyers are permitted to practice on at least a limited basis in England, West Germany, France, Belgium and parts of the United States and Australia without having to requalify locally.

Keidanren (the Japan Federation of Economic Organizations) has expressed its support for allowing foreign lawyers to open offices for private law practice in Japan. The American Chamber of Commerce in Japan has expressed similar support. It is clear that the users of legal services in Japan perceive a real need for the services of foreign lawyers. U.S. companies in Japan can obtain these services from in-house counsel, but the high cost makes that option available only to the largest corporations.

4. Maritime Transport

In recent months, U.S.-flag carriers report, two long-standing Japanese trade barriers in their industry have been removed.

In the past, repositioning of empty marine containers from one Japanese port to another by some U.S. carriers in response to traffic demand required application for customs approval a month in advance of repositioning, and approval was given on a container-by-container basis. This restriction has now been removed.

The measurement requirement for automobile shipments from Japan — which meant physical checking of the outside dimensions of one vehicle of each type loaded aboard ship — has also been dropped. (Pure car carriers were exempt from this requirement, but all such vessels are Japanese-flag ships.)

Three major trade barriers remain. One is the prohibition of movement over Japanese roads of high-cube containers, which are 1 ft (30 cm) higher than the standard-size marine container. Japan is the world's only major trading nation that does not permit their use. Ironically, Japan is a world leader in their manufacture, and new high-cubes move regularly over the roads from factories to Japanese ports for export.

Another barrier is that U.S.-flag carriers find it impossible to enter trucking, stevedoring and warehousing businesses in Japan, though Japanese firms can and do enter these

businesses in the United States. Foreign entry into these important ancillary business lines is no longer restricted by Japanese law, but the Ministry of Transport's licensing policy continues to favor the companies — all of them Japanese — already in these businesses, to the exclusion of new applicants.

Imports of leaf tobaccos by the Japan Tobacco and Salt Public Corporation (JTS) are handled in part by JTS itself but mostly by JTS-designated Japanese trading firms. Carriers are selected by JTS and the trading firms for their respective imports, though the trading firms can only choose JTS-approved carriers. To date, only Japanese carriers have been approved.

After trial shipments (1977-1981) aboard Japanese container vessels of U.S. tobaccos packed in cardboard cases, JTS decided to end its previous practice of importing these tobaccos in hogsheads and to transport them by all-water container vessels on a regular basis. U.S. efforts to obtain a part of this business met with JTS refusal to approve any U.S. carrier. Only after considerable attention was focused on the issue through both official and private channels did JTS agree to use U.S. carriers on a trial basis. These trials involve carriage of a few containers of each type of tobacco involved, over a three-year period, by two U.S. lines.

JTS says that its standard practice is to conduct trials for some years to confirm the safety and economy of any new transportation method. U.S. carriers, pointing to their many years of experience in transporting leaf tobaccos to other parts of the world, say that the present trials are hardly more than a pretext to allow continued monopolization of a \$20 million-a-year business by Japanese carriers.

5. Telecommunications Services

Two proposed laws before the Japanese Diet at mid-1984 would convert Japan's telecommunications services business from a regulated monopoly to a free and competitive market. The draft legislation, however, leaves certain important points unspecified.

The proposed Telecommunications Business Law would set new rules and provide access for foreign firms to the telecommunications services market. It calls for division of enhanced or value-added (VAN) services into two categories, to be defined in a Cabinet order. These categories would be subject to different degrees of government oversight regarding business entry, but the wording does not clearly define the difference.

The proposed Law on Nippon Telegraph and Telephone Ltd. defines rules to be applied when Nippon Telegraph and Telephone Public Corp. is converted from a government-owned monopoly to a semi-private joint-stock company. It lacks transparent provisions requiring separate accounting for basic and enhanced service businesses of the

new firm. The separation of accounting, it is said, should be stipulated in the Ministry of Posts and Telecommunications ordinance that would be issued in regard to the new law.

TSG emphasizes the importance of clear definition of such rules and provision for transparency in their administration, so as to ensure fair competition and national treatment of foreign-owned companies in these markets.

6. Publishing

As in many other Japanese businesses, the emphasis in publishing is on maintaining "an orderly market". Resale price maintenance, not a part of U.S. publishing practice, is standard in Japan. Publishers may opt out of the system, but that almost guarantees their exclusion from the distribution network. Participation protects publishers by ensuring their receipt of a specified percentage of the cover price of their publications nation-wide.

TSG knows of no discrimination against foreign publishers in either Japanese law or in government administration. Working visas for foreign staff, however, are a problem. Editors and those similarly employed are normally permitted renewable one-year working visas. In practice, visas are usually issued for a shorter period. The newcomer may be issued a three-month visa, extended to six months after the first two or three renewals. Only after two or three years in Japan is the employee usually given a one-year visa. This is obviously an unsatisfactory situation for both the editorial employee and his employer.

High Technology

High technology includes advanced products and services ranging from microelectronics, computers and software to telecommunications and satellites. These are sensitive areas of trade in which U.S. and Japanese industries are locked in competition in research and development, marketing and sales. Except for satellites, this competitive struggle spans the globe. Yet the two countries are also important to each other as customers, suppliers and potential generators of new applications and technologies in these fields.

Case studies in each of the five technologies mentioned above illustrate a common theme: the pattern of government/industry collaboration and rationalization efforts by which infant industries in Japan are nurtured until able to compete in world markets.

Government policy for the computer industry, traced from the mid-1950s into the 1970s, was a fourfold program that restricted computer imports, disallowed establishment of wholly foreign-owned computer manufacturing subsidiaries in Japan, required the one U.S. computer firm already

operating such a subsidiary to license its basic technology to Japanese-owned firms in return for manufacturing approval and permission to repatriate dividends, and provided the Japanese firms with subsidies, tax benefits and procurement preferences. This policy was successful — but the American side believes that it also violated a number of U.S.-Japan treaty provisions.

Much the same policy was applied from the late 1960s through the early 1970s to the Japanese semiconductor industry. Though Japan began in 1967 to remove restrictions on inward direct investment, free entry into semiconductor production was delayed until the domestic industry's consolidation and rationalization seemed complete. Moreover, purchase of Japanese semiconductor firms by U.S. buyers was not allowed until 1974 — again, in the American view, a treaty violation.

Computers and semiconductors are no longer sheltered in Japan. But uncertainty has now arisen about Japan's legal protection of software — which today represents the bulk of a typical computer system's cost. Japanese legislation proposed in 1983 would place software, now considered to be protected under the Copyright Law, under a new statute similar to Japan's Patent Law. Protection would be relatively short-term, and the government would have broad powers of arbitration and the ability to compel software licensing. Complete copies of software and source codes would have to be filed with the government if the developer wished to establish a presumption of priority of development.

The reaction of the American business community was immediate, sparked by a belief that the proposed law was an attempt to benefit Japanese software users at the expense of U.S. software developers.

Following discussions between MITI and the Ministry of Education, which administers the Copyright Law, the legislation is now in abeyance. Pending coordination of views within the Japanese government, it is unclear what modifications will ultimately be made to the present means of protecting software in Japan.

Telecommunications services have been provided in Japan solely by Nippon Telegraph and Telephone Public Corporation (NTT), which has never possessed a manufacturing arm. In the past, it used a closed procurement system in which all equipment important to the operation of Japan's telecommunications network was purchased from four key Japanese firms and their affiliates. These four firms also participated in the product development stages of NTT's own R&D program. By 1980, Japan was exporting hundreds of millions of dollars worth of telecommunications equipment per year to U.S. buyers, while all foreign suppliers combined were selling at most a few tens of millions of dollars worth of similar goods to NTT.

NTT procurement was opened in 1981 under terms of

the GATT Government Procurement Code and a newly drafted U.S./Japan Agreement on Telecommunications Procurement. A bid tender system opened foreign access to much of NTT's completely new procurement, though the Agreement covers neither ongoing procurement nor ongoing research projects.

The limited gains since made by U.S. suppliers may now be threatened by legislation before the Japanese Diet at mid-1984 which would reorganize NTT as a semi-private firm. It is unclear how, if at all, the present NTT procurement system will change when this restructuring occurs.

Another bill before the Diet would allow private firms to establish value-added networks. Significant market expansion and opportunities to sell equipment and services directly to new customers are expected after this liberalization of Japan's telecommunications and information service industries. It is a welcome step forward — yet it is unclear whether or not U.S. firms will be offered an equal opportunity to participate in this market.

As for communications satellites, the Japanese government decided in 1978 to promote domestic capability in both the manufacture and launching of satellites. The government's Aeronautics and Space Development Agency (NASDA) was designated as owner and operator of such satellites in Japan. U.S. satellite manufacturers were advised to make joint manufacturing arrangements with Japanese firms if they wished to sell satellites to NASDA.

Most of the satellites purchased and launched by NASDA since 1978 have been manufactured in Japan under such arrangements. The proportion of technology and components supplied by the Japanese side has increased to an estimated 60 – 65% in current projects.

Market-opening measures announced in April 1984 included provisions to allow purchase of foreign-built satellites by private firms — and by NTT and government agencies as well if consistent with Japanese space development policy. The effect of that qualification remains to be seen.

While purely business and technical factors have been important in the rise of Japan's high-technology industries, so also has been government's role in establishing them as world-class competitors. These case studies underscore the fact that Japanese government strategy has allowed American-owned firms to play a far smaller role in creating and sharing in the success of Japan's high-technology industries than would have been the case in a free market.

A new Japanese government strategy is needed — a strategy that (a) does not discriminate between companies that are Japanese-owned and those that are American-owned, and (b) obviates U.S.-Japan trade frictions by promoting fair and equal access of goods and services to Japan's high-technology market.

Intellectual Property

Inventions, brand names and corporate symbols, product styling and proprietary know-how are intangible but highly valuable assets included in a firm's intellectual property. Legal protection of these forms of property is vital to the development of technology, commerce and international trade. Japanese administration of laws protecting intellectual property is even-handed, treating domestic and foreign firms alike. Yet some features of these laws and their administration tend to hamper foreign firms that wish to sell or establish operations in Japan.

The leading problem in patent registration is its slowness. An applicant may well wait six years for the issue of a Japanese patent after filing his application, compared to about two years in the United States. Once applications are filed with the Japanese Patent Office (JPO), the inventions described are vulnerable to unauthorized copying because they are opened to public inspection prior to examination. This is especially true of industrial processes, since Japanese law provides no discovery procedure whereby the courts assist a plaintiff in obtaining proof that his process is being used in a defendant's plant, hidden from public view.

Because a U.S. firm's competitiveness often rests on its proprietary technology, the long wait for patent protection in Japan and the danger meanwhile of unauthorized use can discourage both U.S. exports to Japan and direct investment in manufacturing facilities there. The problem is greatest for high-technology inventions, which often have a short effective product life.

JPO's processing of patent applications is uncommonly slow for two main reasons. First, it is swamped with the world's largest volume of applications — four times the annual number of filings in the United States — and its corps of examiners has remained virtually the same in number for the last 10 years, despite a 5% to 10% annual rise in number of applications filed. This flood of filing is due in part to over-filing by Japanese firms, a result of Japan's first-to-file system of assigning patent rights and to JPO's own preference for single-claim applications. Another factor is the persistence in Japan of utility models — a kind of registration covering simple inventions involving shape or construction of articles and examined by less strict criteria of invention than are patent applications. They were included in Japan's intellectual property system in the 19th century to encourage maximum participation in industrial innovation by the infant industries of the time. They comprise almost half the annual volume of new applications, and must be processed by the same examiners who deal with patent applications.

JPO's inefficient examination practices are the second reason for its slowness. Piecemeal office actions by the examiner as each defect in an application is found, for exam-

ple, greatly delay prosecution of a case as compared to notifying the applicant in a single office action of all defects found (U.S. practice). Unduly brief office actions, with little explanation given for the examiner's objection, make adequate response difficult and often add to the swelling backlog of cases awaiting judgment by appeal examiners.

JPO is launching this year a 10-year program aimed at "paperless processing" of machine-readable applications. It is not clear, however, whether JPO's office automation will be accompanied by the modernization of examination practices also required if processing time is to be reduced to a reasonable level. Meanwhile, no move is evident to expand the corps of examiners — the only medium-term means of reducing the huge backlogs of new applications and appeals.

Slowness of registration is also a problem for trademark protection. Four years or more is typical from filing of application to registration, compared to about 22 months in the United States. Again, the long wait is due largely to understaffing of JPO's corps of examiners and the large volume of applications. Delayed protection of a firm's marks is a particular drawback for foreign firms seeking to introduce their products in Japan. With initial promotion and other start-up costs to justify, they need prompt registration of a relatively few key trademarks. The slowness of JPO's processing favors firms already established in Japan, which can better afford strategic filing of numerous marks well in advance of need.

The first-to-file system means that trademarks already in use abroad can be registered by another party in Japan. JPO may reject such applications if the mark is "well-known" to the Japanese public — but this is often difficult to prove. Other problems posed by JPO practice include unusually strict criteria for renewal of slightly altered marks, lack of protection for three-dimensional trademarks and use of a unique trademark classification system, last updated in 1960, instead of the international system used by the United States and the major countries of Europe.

A troublesome gap in Japan's protection of intellectual property is its lack of nationwide protection of service marks — the marks used by airlines, leasing firms and other suppliers of services rather than goods. Given the importance and rapid growth rate of the services sector in the economies of Japan and its major trading partners, this lack of protection is clearly a significant barrier to development of trade and inward direct investment.

Japan is the only major industrial country without effective legal protection of trade secrets. Such proprietary information is vital to the U.S. information-processing industry and to many other lines of business in which U.S. firms wish to compete in Japan. Lack of trade secret protection makes companies reluctant to use their most competitive technology and business techniques in Japan, due to risk of unauthorized exposure of this information in such an uncer-

tain legal environment.

Structurally Depressed Industries

Sharp rises in the cost of imported energy and raw materials have led to serious structural problems in a number of major Japanese industries such as petrochemicals, fertilizers, paper and aluminum. Government policy and business practices related to these structurally depressed industries have become a new focus of bilateral trade friction during the past year. Like Japan and all advanced nations, the United States also has policies for dealing with the problems of its own depressed industries. Since TSG's purpose is to study questions of market access in Japan, however, Japanese policies and practices are the topic here. Complete agreement within TSG was not reached on some points in this chapter, but substantial consensus was achieved.

Trade friction began with the 1983 enactment of a revised and stronger version of Japan's industrial restructuring law. Once an industry is designated under this law, the government drafts a restructuring plan after consulting with producers, labor, customers and consumers. It sets the amount of capacity to be eliminated, based on medium-term supply/demand projections. Producers taking part can receive government loan guarantees and tax benefits. The revised law emphasizes revitalization efforts, encouraging mergers and other joint actions to concentrate production and marketing. To date, 22 industries have been designated under the law.

The United States contends that these official restructuring plans aim at consolidated capacity equal to domestic demand, leaving imports out of the calculation. In this view, imports are restrained by competition-limiting cartels authorized by the law, and by government/business collusion which is facilitated by the lack of transparency in Japan's policy-making process. Despite substantial price advantages, U.S. officials note, imports have made significant market inroads in only two of Japan's designated depressed industries.

The Japanese government denies these charges, saying that its policy is not to protect depressed industries from imports but to promote their adjustment to structural change by capacity reduction and other revitalization measures. Imports are taken into account in the medium-term supply/demand projections, Japan says. Imports, it adds, have risen in most of these industries, and in related industries.

TSG's analysis of this issue, based mainly on data for the 11 industries designated from 1978 to 1983 under the original restructuring law, finds some merit in both positions. Other than aluminum and ferrosilicon, import penetration is low — less than 7% for nine of these 11 designated industries. Imports' share has dropped in four industries, and in two others imports remain negligible.

Import penetration has increased, however, in most of

the depressed industries. The high penetration in aluminum (imports captured 83% of the market in 1983), ferrosilicon (65%), and certain products that are closely related to ethylene and wet-process phosphoric acid (ethylene was designated under the new law) indicate that restructuring is making progress. Other evidence includes shifts of production from Japan to overseas sites where costs are lower; aluminum smelting, petrochemicals, and paper are examples.

Although adjustment is occurring, the fact that import penetration remains low in most designated depressed industries is cited by the United States as important evidence of Japanese protectionism. The restructuring law itself contains no provision for restricting imports, but one aspect of the law questioned by the United States — and one that conflicts with OECD industrial policy guidelines — is the lack of transparency in its implementation. Japanese policy-making is rarely conducted in a public forum; many key decisions about industrial restructuring plans are made in private discussions between Japanese businessmen and government officials, raising suspicions about quiet understandings that may be intended to restrict imports. In an attempt to overcome this problem, the United States is seeking to participate in Japan's Industrial Structure Council, where industrial restructuring plans are formulated. The Japanese government has said that foreigners can appear as witnesses at Council meetings when invited by the Chairman, but TSG believes that the Council must make a stronger commitment to foreign participation and to open communication of its views in order to ensure genuine transparency. It is also important for Americans to make greater efforts to tap existing sources of information.

The United States also questions the law's effectiveness in promoting genuine restructuring. A key objective is to eliminate excess capacity. Yet, except for aluminum and ferrosilicon, even the smaller capacities targeted for these industries in 1988 remain well above present domestic demand — although demand has been stable or declining in recent years. These high capacity targets, says the United States, suggest that Japan is still pursuing its traditional policy of self sufficiency. But to Japan, the high targets reflect the need to win consensus for restructuring plans among producers who are reluctant to reduce capacity.

U.S. officials further contend that industries agree to capacity-scraping plans under the law in return for administrative guidance by the Japanese government that limits inroads by imports in the relevant product lines. Recent cases cited by the United States — involving ammonia and urea, ferroalloys, soda ash, petrochemicals, and caustic soda — illustrate ways in which the United States believes *de facto* import restraints are applied. These cases also underscore the problems of proving the use of administrative guidance — by nature an informal, unwritten process — to limit imports. The American side of TSG believes that the Japanese government

has used administrative guidance to limit imports; the Japanese side does not believe the government has done so. Both sides agree that much of the U.S. case for the existence of official protectionism in Japan's depressed industries is unproven.

In addition to questions of government policy, the U.S. case against Japanese protectionism also includes charges against the business practices of Japanese firms. Here, too, the evidence is mixed. Some practices, while aggressively competitive, do not appear to violate Japanese law or international trade agreements. More questionable is the common practice of Japanese manufacturers who pressure customers or trading companies not to buy competing imports. This pressure, usually in the form of a threat to suspend future supplies, is believed by American legal authorities to violate Japan's Antimonopoly Act; Japanese concepts of anti-monopoly enforcement, however, seem to be less strict than American standards.

Japanese firms also have more benign reasons not to buy imports. Among them are a cultural preference for stable, long-term business relationships with well-known customers and suppliers, and the inevitable concern of an island nation with reliability of supply. Equally important obstacles to trade lie on the U.S. side: many American firms are unwilling to make the long-term marketing commitment or product adaptations that are necessary to sell in Japan; Japanese buyers also say that some U.S. firms are unwilling to meet Japanese quality requirements.

Legitimate as these factors are, it appears that Japan sometimes exaggerates their importance in attempting to justify the low level of Japanese imports. It is difficult to escape the suspicion that the issue of reliable supply is sometimes an excuse for protecting domestic production and jobs. A fundamental reason for having reservations about Japan's emphasis on reliability of supply is that Japan's depressed industries are largely dependent on imports for their raw materials. Since Japan has succeeded in obtaining secure overseas supplies of the raw materials, it is reasonable to believe that Japan could also find secure foreign supplies of the manufactured products.

Key findings of TSG's investigation of the depressed industries issue and recommendations for reducing the trade friction arising from it are presented in summary lists at the end of Chapter 7.

Investment Policy

Trade in goods and services is only one aspect of the U.S.-Japanese economic relationship. It has rather overshadowed other aspects because of the large U.S. deficits recorded in merchandise trade with Japan in recent years. Direct investment by U.S. firms in manufacturing and marketing facilities in Japan, however, is also a significant aspect

of bilateral economic relations.

There is considerable evidence that a manufacturing presence in Japan can win access to markets that are difficult to penetrate through imports. Local manufacturing can also enhance the position of imported products already established in the Japanese market, and may stimulate additional exports from the United States of related goods and services. Similarly, some recent investments by Japanese firms in the United States reflect a concern that their U.S. market share may not be sustainable without a local manufacturing presence. Liberal investment policies in both countries are at least as important to sound economic relations as are liberal trade policies.

Japanese investment policy is embodied in the Foreign Exchange and Foreign Trade Control Law as amended in 1979. The Law requires 15 days prior notice to the government before a foreign direct investment can be made in Japan. The government can block such an investment for various specified reasons, though this power has not been used in the four years since the revised Law came into effect. There are restrictions on foreign direct investment in a number of specific industries, as is true also in the United States.

The difference between the climates for foreign investment in the two countries lies not so much in explicit statutory restrictions but in the fact that business is subject to closer government regulation in Japan than in the United States. Such regulation has had the effect of restricting foreign entry completely or significantly in several service industries. Much regulation is exercised through administrative guidance, under circumstances that make it difficult for the investor to challenge in a neutral forum treatment he considers unfair or unreasonable. This approach to regulation is likely to be a continuing source of friction between the United States and Japan.

At the same time, however, new inward investment in general is being promoted by local authorities in Japan as well as by the national government — both as a means of easing trade friction and through self-interest in expanding the employment base in Japan. Government-supported financing has been made available to Japanese affiliates of foreign firms, and a variety of incentives already available but not well-known to the foreign business community have been pointed out to potential investors. Investment seminars held by the government in Japan and overseas and industrial site inspection tours organized by individual prefectures are some of the approaches being used to attract more foreign investment.

The incentives approach is a positive step and its expansion should be encouraged. It seems unlikely that these programs will significantly affect the ability of foreign firms to acquire substantial equity interest in established Japanese

firms, however. Existing patterns of interlocking stock ownership make such acquisitions very difficult. Other factors inherent in Japanese relationships between management and employees, suppliers and customers, and lenders and corporate borrowers are further obstacles to foreign takeovers that limit the opportunities for market penetration by that route.

New U.S. investment in Japan — especially that by new-to-market firms — will likely be concentrated in dynamic, fast-growing sectors of the economy, and this should minimize industry opposition to new entrants. Good opportunities for expansion of existing U.S. investment may also arise in mature or declining industries or in politically sensitive sectors, though this is more apt to bring new pressures on the government to restrict foreign entry.

The United States, having historically followed a policy of almost complete freedom of entry for foreign investment, has no comprehensive notification or approval system governing foreign exchange or foreign investment. Both inward and outward capital flows have been essentially unregulated since the end of World War II. As noted above, however, foreign investment is restricted by law in some specified in-

dustries.

U.S. regulation of industry has been relatively transparent — the result of laws requiring government agencies to act in accord with clearly defined procedures that aim at insuring objectivity and providing public, impartial adjudication of grievances by those subject to regulation. In recent years, however, there has been a growing perception in Japan that the United States is moving toward less transparency and more discretion in its policies for regulating foreign competition. There is a growing belief that the United States is becoming more protectionist and thus less liberal in its treatment of foreign firms seeking to compete in the U.S. market.

Japanese firms in the United States express concern about having to deal with conflicting regulations of different government agencies. Such conflicts, arising from multiple-level regulation, may be more of a problem in the United States because of its federal system of government. Perhaps the most serious problem of this kind to emerge in recent years is the adoption by several states of the worldwide combined unitary apportionment method of taxing multinational corporations operating in those states.

Chapter 1

U.S. AND JAPANESE BARRIERS TO TRADE AND INVESTMENT: A GENERAL COMPARISON

This report is mainly a survey of progress in removing Japanese trade and investment barriers, and of the extent to which these barriers remain in Japan. It should be remembered, however, that there are such barriers in the United States as well.

Since some of Japan's successes in the U.S. market were achieved in spite of U.S. barriers, it is sometimes argued that U.S. exporters and investors need only emulate Japanese diligence to be comparably successful in the Japanese market. The American perception, however, is that the primary obstacle has not been lack of American diligence, but rather the great variety of barriers — and lingering effects of past barriers — imposed by Japan.

From the information presented in the following chapters, the reader may decide whether the American perception is justified. The aim of this chapter is to provide perspective by a brief review of the major areas in which trade and investment barriers exist in both countries.

1. Tariffs

Once the tariff cuts decided in the Tokyo Round multilateral trade negotiations are fully implemented in 1987, average tariff rates in both the U.S. and Japan will be low. Japan's average rate (3%) will be lower than that of the United States (4.2%). Comparison of average tariff rates alone is not adequate, however, because products that are successfully excluded from the market by very high tariffs or by import quotas are given little weight in the computation.

For this reason, it is useful to compare the lists of products for which high tariff rates (25% or more) in either Japan or the United States are regarded as a substantial impediment to trade.

Japan	United States
Beef	Certain wool fabrics and wearing apparel
Milk and cream	Certain man-made woven fabrics and wearing apparel
Butter and cheese	Certain cotton wearing apparel
Fresh oranges	Certain glassware
Chewing gum	Certain jewelry
Biscuits, cookies, etc.	Gloves and glove linings

Japan	United States
Menthol	Large motorcycles (temporary tariff until April 15, 1988)
Patent leather and imitation patent leather	
Certain footwear with outer soles of leather or composition leather	
Citric acid	
Ski boots	

Comparative tariff rates (as of year-end 1983) for selected products of interest to U.S. exporters are shown below.

	Japan (CIF Japan)	United States (FOB port of export)
Beef	25.0%	2¢/lb
Fresh Oranges Jun–Nov	20.0%	1¢/lb
Dec–May	40.0%	1¢/lb
Veneer	15.0%	nil
Kraft paper	9.3%	2%
Calf leather	20.0%	3.6%–7.3%
Bourbon whiskey	24.5%	43¢/gal
Chocolate confectionery	20.0%	5%–7%
Particle board	13.1%	5%–7%
Wrought copper bars (unalloyed)	9.0%	1.3%

2. Quotas

Quotas are a more invidious form of trade restriction than are tariffs. They invite cartelization, discourage competition, provide no government revenue and hurt the consumer. Moreover, it is harder to quantify the trade-impeding effect of a quota. For example, it is impossible to know what Japan's consumption of beef would be if there were no beef import quota. Yet both governments continue to resort to quotas as a means of controlling trade in some categories of goods. Items currently under import quota in each country are listed below.

Japan	United States
Rice and rice products	Fodders containing milk
Wheat and wheat products	Certain chocolate products
Barley and barley products	Malted milk
Beef	Ice cream
Milk and cream	Milk and cream
Processed cheese	Butter and cheese
Canned beef or pork	Butter substitutes
Shore fish and cod roe	Cotton and cotton waste
Scallops, squid, etc.	Refined sugar
Edible seaweed	Peanuts
Oranges and tangerines	Beef (temporary quota under Meat Import Act)
Fruit purees and pastes (some to be freed in fiscal 1984)	Certain English-language books, magazines, etc.
Canned pineapples	Automobiles from Japan (temporary agreement until March 31, 1985)
Fruit juices (some to be freed in fiscal 1984) and tomato juice	Specialty steel (temporary agreement until July 19, 1987)
Tomato ketchup, etc.	Textile articles under GATT Multi-Fiber Agreement
Starch and inulin	
Grape sugar, etc.	
Certain beans	
Peanuts	
Tubers of devil's tongue	
Food preparations containing added sugar, milk, seaweed, wheat, etc.	
Coal	
Leather and leather footwear	

Japan also maintains controls over the quality, design, price, payment terms and/or quantity of *exports* of the following products: insulated electric wire, bicycles, cigarette lighters and parts, tableware and kitchenware made of porcelain or china, certain table utensils, pearls, numerically controlled machine tools, and portable motion picture cameras.

3. Anti-Dumping Measures

The U.S. anti-dumping law permits the assessment of compensating duties if it is determined that a class of foreign goods is being sold (or is likely to be sold) to buyers in the United States at less than fair value and that such sale materially injures a U.S. industry or retards its establishment.

American and Japanese attitudes toward anti-dumping investigations often differ sharply. These investigations are widely regarded by Japanese as a form of harassment, but by Americans as a legitimate response to an unfair Japanese trade practice. Both sides agree, however, that the U.S. anti-dumping orders now in effect against Japanese products, listed below by year of imposition, have little impact on Japanese exports. The same may be said of countervailing duty orders now in effect. There are no Japanese anti-dumping or countervailing duty orders in effect against U.S. products.

U.S. Anti-Dumping Orders Against Japanese Products

- 1970
 - Tuners
- 1971
 - TV receivers, ferrite cores, clear plate and float glass, clear sheet glass, tempered sheet glass
- 1972
 - Fish netting of man-made fibers, large power transformers. cadmium, bicycle speedometers
- 1973
 - Roller chain, synthetic methionine, steel wire rope, polychloroprene rubber
- 1974
 - Expanded metal, calcium pantothenate
- 1976
 - Birch three-ply doorskins, tapered roller bearings, acrylic sheet
- 1977
 - Melamine in crystal form, metal-walled aboveground swimming pools
- 1978
 - Impression fabric of man-made fiber, carbon steel plate, steel wire strand
- 1980
 - Spun acrylic yarn, portable electric typewriters, large electric motors
- 1982
 - Stainless steel clad plate, high-power microwave amplifiers
- 1983
 - Certain steel pipes and tubes, high-capacity tone-only pagers
- 1984
 - Cyanuric acid

U.S. Countervailing Duty Orders Against Japanese Products

- 1977
 - Nuts, bolts and capscrews
- 1978
 - Iron and steel chain
- 1979
 - Certain fasteners

4. Government Procurement

Procurement by governments and government-owned enterprises is another matter about which U.S. and Japanese perceptions differ. There is Japanese concern about "Buy American" laws, particularly those state laws that have no relation to defense or national security. Such laws require that procurement of steel, construction services or the like by state agencies or state enterprises be limited to American-owned suppliers. Many Americans, while agreeing that such laws are undesirable, point out that at least they are specific and transparent. Japanese government procurement policies, by con-

trast, tend to be non-transparent and sometimes contradict in practice what has been accepted in principle.

The history of procurement by Nippon Telegraph and Telephone Public Corporation (NTT) is a leading example of this problem. The 1953 Treaty of Friendship, Commerce and Navigation (FCN Treaty) between the United States and Japan provides that Japanese government-owned enterprises such as NTT should base their procurement decisions solely on commercial considerations and should afford U.S. suppliers adequate opportunity to compete. But this rule was ignored for nearly 30 years, during which NTT built its all-Japanese "NTT family" of suppliers. NTT has opened its procurement since 1981 under terms of the GATT Government Procurement Code and the U.S./Japan Agreement on Telecommunications Procurement. In the American view, however, Japanese affirmative action is needed to redress the lingering effects of past discrimination in procurement as exemplified by the NTT case. These issues are considered further in Chapter 2.

5. Foreign Direct Investment

In the United States, foreign direct investment is generally unrestricted, except in a few industries related to defense or national security. The worldwide unitary method of taxing corporate income, however, is viewed in Japan as a substantial disincentive to investment in the dozen or so states

that practice it. Under this method, the worldwide income of the corporate group is combined and then allocated to the state under various formulas such as the state's share of the corporate group's worldwide property, payroll and sales.

In Japan, there are American objections to the requirement of prior review by the Ministry of Finance of all foreign direct investments. U.S. sources also point out that some Japanese industries that ostensibly are open to foreign direct investment are in fact closed, because of administrative guidance applied by the ministries involved. This is particularly true of industries under supervision of the Ministry of Finance (such as underwriting and auditing) and those under the Ministry of Transport (such as warehousing, stevedoring and trucking).

* * *

Most businessmen, Japanese and American alike, are not experts on trade or investment barriers and do not wish to become so. When confronted by such restraints, their response is to consult with an expert on the barrier in question, deal with the problem to the extent possible and then proceed with business. Free access to such experts — lawyers, accountants and consultants — is therefore important to a businessman operating in a foreign country. In particular, access to experts of his own nationality may be important, as is discussed in the "Legal Services" section of Chapter 4.

Chapter 2

GENERIC PROBLEMS

INTRODUCTION

Non-tariff barriers may be specific to a single industry, affecting a narrow range of goods or services. Some NTBs, however, are far-reaching in their impact. Barriers found in standards, customs valuation methods and clearance procedures, government procurement policies and import licensing practice, for example, can restrict trade across a broad front.

Such NTBs are best dealt with as generic trade problems, TSG believes, because corrective action through changes in law, government policy or commercial practice at the most general level at which the problem is found can eliminate at once the specific forms which the NTB may take in all the product or service areas affected.

Generic NTBs were a major theme of the Tokyo Round multilateral trade negotiations, initiated by GATT (General Agreement on Tariffs and Trade) in 1973 and concluded in 1979 with the adoption of eleven Codes setting out clearer, more equitable rules of trade. Japan acceded to all the new GATT Codes, which came into effect in Japan during 1980 and 1981.

Many of the problems under investigation by TSG's Generic Program Committee were covered by four of these Codes. Accordingly, in 1981 the committee was regrouped into three task forces to monitor respectively Japan's implementation of the Standards Code, the Government Procurement Code, and the Customs Valuation and Import Licensing Codes. This chapter reports the findings of the three task forces as to the effectiveness of the Tokyo Round GATT Codes in eliminating generic NTBs in Japan.

Along with its accession to the GATT Codes, the Japanese government has taken unilateral initiatives in the direction of trade liberalization. Chief among them have been a major revision of the Foreign Exchange and Foreign Trade Control Law, effective December 1980, and a series of market-opening 'packages' — groups of tariff cuts and measures aimed at eliminating NTBs — starting in January 1982. The effectiveness of these moves in removing generic NTBs is also evaluated in this chapter.

Finally, problems that remain are described and TSG's proposals for solving them are presented.

BACKGROUND

Japan's approach to trade regulation, like that taken in the United States, is conditioned by the nation's history — and in particular by the relationships that evolved between business and government as both sectors grew into their modern form. Mutual understanding of the attitudes embodied in today's trade practices in the two countries, we believe, is essential in resolving bilateral trade disputes. Useful insight can be gained through a brief review of the contrasting routes by which trade regulation developed in Japan and in the United States.

Except for quotas, government procurement and "buy local" practices, most Japanese regulations and procedures that create problems for foreign exporters to Japan were not created with the specific intent to discriminate against foreign goods. Very often, the core of the problem is that the foreign seller cannot obtain sufficient information or cannot sufficiently influence decisions affecting his interests to operate effectively in Japan.

This situation is an outgrowth of the close, paternalistic relations between Japanese government and business that have existed for well over a century. Japanese manufacturing industry was established during the Meiji Period (1868–1912), largely by government initiative. A new national government, having just replaced the feudal administration that long ruled Japan, saw rapid industrialization as an instrument to ward off foreign domination. To get its program in motion, the government itself built and operated plants to supply the key industrial products of the day.

These properties were later sold on favorable terms to entrepreneurs judged capable of making them grow and of expanding into other businesses useful to economic development. These fledgling enterprises, having become privately owned instruments of public policy, continued to receive government assistance and advice. Thus, from the start of industrialization, the government took a more dominant role in economic decision-making in Japan than had been true in the United States.

An example of the consequences can be seen in the area of product standards and testing. In the United States, voluntary standards are a widely recognized means of protecting the public from dangerous or defective goods. In Japan,

by contrast, the government relies on officially-set norms, standards and testing requirements. The government's central role in standards-setting began with procurement specifications issued by its own industrial operations in the early Meiji Period. Reinforcing the government's role is the traditional respect given to government administrators in Japan. Government employment is regarded as a high calling by Japanese university graduates, and the Japanese businessman may hesitate to bring about a direct confrontation with a government official. Americans, whose social history does not include this kind of hierarchical distinction, often find themselves at odds with this Japanese tradition.

In the development of U.S. standards, by contrast, businessmen assumed responsibility for regulating themselves. Standards-writing in the United States began with an 1838 document dealing with the problems of steam boiler explosions. Manufacturers, consumers, academicians, government officials and public-interest groups all had a hand in drafting that standard, and the same variety of participants still prevails in the American approach to standards-writing. Free access to the process is protected by the Antitrust Division of the U.S. Department of Justice, which ensures that all aspects of due process, including the right of appeal, are observed. In particular, participation cannot be limited to members of standards-writing associations, nor can interested foreign individuals, firms or associations be barred from taking an active part in drafting standards.

The standards thus written seldom acquire the force of law. Those that do are generally adopted at municipal, county or state level. Far less often, federal legislation is enacted to adopt such a standard nationwide. One result is that the American system, though fully accessible to all who have a legitimate interest, does not generate uniform rules that ensure acceptance of a manufacturer's product in all parts of the United States. For some goods — U.S. and foreign alike — the existence of many local technical standards can create a serious marketing problem.

Both the Japanese and the U.S. standards-writing systems thus reflect the historical circumstances in which they evolved, and neither system was intended to impede foreign trade *per se*. Both have been affected by provisions of the GATT Standards Code, so as to accommodate the needs of foreign traders.

GATT CODES IMPLEMENTATION

After four years of experience in Japan with the Standards Code and Import Licensing Code, and three years with the Government Procurement Code and Customs Valuation Code, the progress made in eliminating NTBs within the scope of these agreements is very encouraging. The impact of each Code and the remaining problems will be reviewed.

Agreement on Technical Barriers to Trade (Standards Code)

Key provisions of the Standards Code and Japan's record in conforming to them are summarized below.

1) Technical regulations and standards should not create obstacles to international trade.

Status: Since Japan's accession to the Code, it does not appear that Japanese regulations or standards have been prepared, adopted or applied in ways that create barriers to trade or that treat foreign goods less favorably than domestic goods.

2) Relevant international standards should be the basis for technical regulations and standards.

Status: In many cases, newly enacted or revised technical regulations have drawn upon appropriate international standards.

3) Each country should participate in appropriate international standards organizations with a view to harmonizing existing or newly drafted technical regulations and standards.

Status: Japan has contributed to the work of the International Standardization Organization (ISO) and the International Electro-technical Commission (IEC) for many years, and is one of the three nations (with the United States and West Germany) that bear the largest share of their cost.

4) Technical regulations and standards should be written in terms of performance rather than design.

Status: Several Japanese standards containing objectionable design restrictions were revised during the past year, design limits being replaced by performance tests. As examples, the design standard for electrical cords for appliances was replaced by an IEC performance test, and the limits on thickness and diameter of aerosol spray-cans were replaced by "proof and burst" tests.

5) When relevant international standards do not exist and the adoption or revision of a technical regulation or standard may have a significant effect on trade, (a) notice should be published for the information of interested parties; (b) other countries should be notified through GATT; (c) interested parties should be provided with particulars; and (d) written comments should be accepted, discussed with the commentators on request, and taken into account in the drafting or revision process.

Status: Japan's adherence to the provisions for prior notification has been generally good. In 1979, before the Code was actually signed, JETRO (Japan External Trade Organization) began its present practice of publishing notices of intent to write or revise standards. These notices appear in the Japanese-language *Tsusho Koho* (JETRO Bulletin). However, the Ministry of Foreign Affairs (MOFA) forwards

English-language synopses to GATT for transmission to member countries. In the United States, these synopses are being published in the *ANSI Reporter*, published by the American National Standards Institute (ANSI). MOFA also supplies them to the American Embassy in Tokyo for use by U.S. business interests in Japan. The Embassy provides copies to the American Chamber of Commerce in Japan, which notifies its resident and overseas members. Foreign comments, meanwhile, are being taken into account in Japanese standards-writing.

It should be noted, however, that Japan does not provide the proposed standards or revisions themselves to GATT. They are available only in Japan and only in the Japanese language. In some cases, the deadlines listed in MOFA notices have been far too short for preparation of comments. A few notices have in fact been released at the deadline itself. In other cases, new standards have been published in *Kampo* (the *Official Gazette*) the day after the deadline for comments. Since it takes several days for *Kampo* to set type for its notices, it is obvious that no attempt was made to consider comments from abroad. This point has been made to MOFA, which has promised to be more careful in the future.

In March 1983 the Japanese government announced that a minimum of nine weeks (63 days) following notice of a proposed standard would be provided henceforth for submitting comments — unless serious risk to health or environment would result from such delay. This rule, however, has not always been observed. For example, the Ministry of Agriculture, Forestry and Fisheries (MAFF) published on July 8, 1983 a Notice of Standards Drafting Schedule regarding official standards for ordinary fertilizer. The deadline for comments was July 22 — only 14 days later, and 11 days after receipt of the notice by the American Embassy. Moreover, the MAFF notice stated that comments would only be accepted through government-to-government channels, not directly from foreign interested parties. In view of the Japanese government's public pronouncements of intent to improve foreign access, TSG had hoped for a better example to be set than that provided by MAFF.

6) Imported goods should be tested under conditions comparable to those for domestic goods. Governments are encouraged to accept test results, certificates or marks of conformity issued by relevant bodies in other countries, or self-certification by manufacturers. (This provision applies even when test methods used abroad differ from local practice.)

Status: Certification systems and marks of approval have often imposed major trade impediments. In the December 1979 "Joint Statement on Standards, Testing and Certification Activities" (Section 3), the United States and Japan agreed that foreign suppliers should have "direct access" to approval agencies, except that "for reasons of ac-

countability, the importing country may require that, in place of a supplier in the exporting country, a representative in the importing country file the formal application."

In May 1983, 16 laws were amended as part of a Japanese government program announced two months earlier to liberalize standards and certification systems. With these changes, foreign suppliers obtained the direct access denied in the 1979 joint statement. They also became able to apply for and hold certifications for their products, and to affix marks of approval at the factory. (Previously, each lot of products had to be inspected at the Japanese port of entry before such marks could be affixed.)

Japan still does not accept certifications or marks of conformity issued by relevant bodies in other countries. Nor have TSG requests for self-certification by U.S. automobile manufacturers been granted. TSG notes that millions of Japanese automobiles enter the United States each year on the basis of self-certification by their manufacturers.

7) Certification systems should not create unnecessary obstacles to international trade.

Status: It appears that certification systems are not being formulated or applied in Japan with a view to creating obstacles to international trade. However, some residual problems such as those cited in section (6) above remain to be solved.

8) Certification systems and "marks of the system" should be formulated and applied so as to grant access to imported goods under conditions no less favorable than those for domestic goods.

Status: Another point in the Japanese government's March 1983 program to liberalize standards and certification systems was the acceptance of foreign test data. "Results of tests conducted by foreign testing organizations or firms of foreign countries will be accepted except when there exist compelling reasons not to do so if the reliability of such data is confirmed." Yet the rules for appointing a "designated testing laboratory" required that it be chartered under Japan's Civil Code — meaning that no foreign organization qualifies.

In April 1984, however, the Ministry of International Trade and Industry (MITI) announced that it will accept data from designated foreign inspection and testing laboratories in connection with mandatory standards imposed by laws under its administration. Under five MITI-administered laws, data from designated foreign laboratories may be submitted directly to MITI. Under three others, data for type approval generated by designated foreign laboratories must be submitted through a designated Japanese laboratory. For factory registration, however, foreign data may be submitted directly to MITI.

Applied Research Laboratories, a U.S. independent laboratory which is a profit-making corporation, has already

been designated under the Electrical Appliance and Material Control Law. TSG urges other government agencies to initiate similar procedures so that U.S. exporters to Japan may have ready access to Japanese-designated testing laboratories in the United States.

9) An enquiry point should be provided to answer all reasonable enquiries regarding existing or proposed technical regulations, standards and certification systems.

Status: Japan has provided the required facilities for making enquiries. There are two such "windows": one each in MOFA and JETRO. Between the two, all questions can be answered. The system seems to be functioning effectively. The enquirer can receive a verbal briefing followed by a written statement detailing any laws that could affect the import and sale of his product.

Standards Matters Outside the GATT Standards Code

1) Foreign Participation in Standards Writing

Thanks to the Standards Code, advance information about proposed new standards and revisions in Japan is more readily available to foreign interested parties. The standards-writing process, however, still falls far short of transparency. TSG has long urged the Japanese government to go beyond the letter of treaty obligations and permit foreign participation on the industry panels that prepare the preliminary drafts of Japanese standards.

In 1983, to facilitate foreign participation in the writing of Japanese Industrial Standards, MITI released a list of more than 200 standards that were being drafted or revised in fiscal 1983 by some 120 industry panels by arrangement with MITI. MITI announced that it would recommend to any of these industry association panels that in principle one qualified U.S. representative be allowed to participate in its activities. The same offer applied to other countries.

TSG believes that the limit of one representative per country on a Japanese standards-writing panel is unnecessarily restrictive. Under these rules, the European Community is eligible to send 10 representatives while the United States may send only one. Because the population and GNP of the United States and those of the European Community are roughly equal, the "one country, one vote" rule falls short of equity of interest.

Further, the Japanese industry associations involved are under no obligation to accept foreign participants recommended by MITI. The Agency for Industrial Science and Technology, which administers Japanese Industrial Standards, did obtain approval from all associations involved in the 1983 list, and TSG hopes that it will be able to do so in the future.

The Japanese standards-writing system should be further liberalized so as to approach the European, if not the

U.S., level of openness. As an example of U.S. practice, the roster of an American Society for Testing Materials task force on cigarette lighter safety in 1979 numbered 48 members, 12 of whom were Japanese nationals, including nine resident in Japan.

TSG recognizes that plural foreign representation on Japanese standards-drafting panels presents several problems for the associations. The membership of these panels must include a specified balance of producers, consumers and public-interest representatives. If numerous representatives were sent from producers abroad, the associations would have to increase the number of members of each panel substantially, compounding the problems of scheduling and logistics. This problem might be reduced by creating a category of foreign "observers", which could satisfy the needs of many potential foreign participants. MITI has advised TSG that such requests should be presented on a case-by-case basis.

2) Foreign Access to JIS and JAS Certification

Among the most widely recognized standards in Japan are the two comprehensive systems known as JIS (Japanese Industrial Standards) and JAS (Japan Agricultural Standards). Though these standards are voluntary, the JIS mark or JAS mark as an indicator of the maker's compliance with the standards is a symbol of quality and reliability to Japanese buyers.

To apply either mark to a product, the maker must first receive government certification. (MITI is the JIS supervisory agency for most manufactured products, MAFF the JAS supervisory agency.) Certification involves an initial inspection of the production facilities and practices used. In accord with the GATT Standards Code, Japan moved to make JIS marks accessible to overseas producers by changes in the Industrial Standardization Law that allowed foreign factories to apply for JIS approval from 1980. To date, two U.S. factories and more than 30 other factories outside Japan have been inspected and permitted to affix the JIS mark on the products certified. After an overseas factory is JIS-approved, follow-up inspections can be delegated to non-profit foreign testing institutes.

There remains, however, a serious obstacle to U.S. access. Neither MITI nor MAFF has been willing to delegate the initial factory inspection to foreign inspection agencies. (Follow-up inspections of JIS-approved overseas factories can be delegated to non-profit foreign testing institutes.) Though the JAS mark system is now open to overseas producers as well, factory inspections must be conducted by MAFF officials. (Follow-up inspections may be conducted by U.S. Department of Agriculture officials or non-profit testing institutes.)

3) Access to Information about Changes in Standards, Laws and Regulations

Current, authoritative information about changes in Japanese standards, laws, regulations and official procedures is available in only one published source: *Kampo* (the *Official Gazette*), which is published in Japanese only and which is not indexed, either in each issue or annually. Nor has the government ever requested an International Standard Serial Number (ISSN) for *Kampo* so that it could be included in the readily accessible ISSN classification of official and private publications world-wide.

TSG repeats its longstanding recommendation that the Japanese government issue a periodical publication, indexed in the manner in general use internationally, to provide current information about changes in laws, regulations and procedures that affect exporters to Japan.

Customs Valuation Code

The aims of the Customs Valuation Code are to clarify the methods of valuing imported goods for tariff assessment and to bring about greater uniformity in the methods used for such valuation, so as to avoid the use of arbitrary or fictitious values in assessing customs duties. The Code also calls for procedures for consultation and settlement of disputes.

To conform with this and related Codes, substantial changes were made in Japanese law affecting customs valuation, countervailing duties and anti-dumping duties. The primary basis for valuing goods for customs purposes is now the "transaction value", that is, "the price actually paid or payable for the goods when sold for export", plus certain other expenses associated with the transaction but not included in the price, such as packing costs, royalties and license fees, and commissions (except buying commissions).

When buyer and seller are "related" and their relationship is considered to influence the transaction value of the imported goods, the value is assessed by other methods. The transaction value of identical goods imported into Japan may be used. If sufficient data for that approach are lacking, the transaction value of similar goods can be used. And if that value cannot be determined, the importer can request that the unit price at which the same or similar goods are sold, minus deductions for port costs, profit, etc., be used to determine the customs value of the goods.

This provision for uplift of the transaction value for "related company" transactions, while permitted by the Code, appears to be one of the few sources of difficulty in customs valuation since the Code came into effect in 1981. Because a substantial volume of Japan's imports pass from offshore offices to domestic offices of the same trading company, these firms have felt the heaviest impact of such uplifts in assessed value. TSG believes that related-company transactions should be expeditiously monitored on a sampling basis, in accord with the intent of the Code.

Another problem is that in Japan, as in the European

Community, customs duties are assessed on CIF value, while in the United States, as in Canada, Australia and New Zealand, they are assessed on FOB value. The CIF basis, though not a Code violation, is especially unfavorable to goods shipped by air. TSG proposes that Japan should study the possibility of changing from CIF to FOB evaluation or should assess airborne goods on the basis of ocean freight costs. This would not contravene GATT principles.

The Code also gives importers the right to appeal without penalty to customs authorities or to an independent body in disputes over customs value determination. Japan has done much to provide the means for a fair and impartial hearing of grievances related to customs valuation and classification. Some of these are informal, non-adversarial approaches.

Another avenue of appeal against customs practices was opened in 1982 by the establishment of the Office of Trade Ombudsman (OTO) in Japan's Economic Planning Agency. OTO is discussed below, in the section titled "Market-Opening Packages".

1) Customs Classification

The Ministry of Finance (MOF) established in 1983 a system whereby an importer may obtain an advance ruling on customs classification that will be honored at all ports of entry. Although these rulings may be conditional to the extent that they include "opinions" on technical regulations and commodity taxes, the MOF system is a major contribution to resolving the longstanding complaint of many importers that identical goods have been assigned different customs classifications at various Japanese ports.

In another step, taken at the request of trading groups, officials of the Custom-Houses have met for the purpose of unifying tariff classification throughout Japan. But the unification process is being carried out by officials of Tokyo Customs, and it is reported that officials in other districts do not willingly follow the lead of Tokyo Customs. TSG proposes that a unification center be established in the Ministry of Finance and that its decisions be promptly published for public inspection.

2) Tariff Rates

Japan has carried out tariff rate reductions even faster than called for by the Tokyo Round. The reductions have often applied to items of little trade significance, however, and as a major industrial power Japan should further reduce or abolish duties on industrial products such as machinery and equipment. With few exceptions, there should be no protective duties to shelter Japanese industry.

Duties on aircraft and aircraft parts are a special case, dealt with in the GATT Civil Aircraft Trading Code. It provides that these goods be exempted from customs duties and other charges, given appropriate "end-use conditions". Japan complied, providing exemption entitlement procedures by amendment of the Cabinet Order for Enforcement of the

Customs Law. The new procedures are so complicated, however, that most clearances are being conducted under the old system as the lesser evil. The entitlement procedures should be replaced by a simple blanket declaration by the airline or the importer, and all other procedures should be eliminated.

3) Entry of Goods

As a major trading nation, Japan must be in the forefront of efforts to eliminate trade barriers. Yet its administrative trade procedures today do not demonstrate Japan's efficiency as an expeditor of world trade.

At present, the basis for regulation is that trade is *prohibited* until permits are granted by trade officials. The permit system means, in effect, that all cargo is "impounded" until government officials "clear" it. The cumbersome clearance procedures lead some potential trading partners to decide against selling to Japan.

Trade officials must be persuaded that, as public servants, their expediting the movement of goods is in the interest of free trade and therefore in the interest of the Japanese public. Most goods moving in trade benefit the trading partners and the end-users in Japan and overseas. Goods should not be delayed in transit except in specific cases where there is reasonable cause to suspect trade-related crime such as smuggling. Prevention, detection and punishment of trade-related crime should not be allowed to interfere with the general flow of trade, the vast majority of which is legal. Efforts to apprehend the few violators of the law must not put the *bona fide* trader in a position where he must petition for this right to trade.

Freedom of trade is seriously infringed when officials cause delay through procedures not clearly defined by law. In determining whether goods should move or be held up, the burden of proof should be on the authorities, not the shipper. In short, trade officials should be motivated to view themselves in the same light as police officers assigned to traffic control, who must enforce the law while keeping the traffic moving.

All routine processing of trade documents should be done concurrently with the movement of the goods unless there is evidence of crime or unsafe conditions involving a specific shipment. Cargo should not be delayed simply to complete administrative requirements.

Above all, procedural requirements should be clear to all concerned and uniformly applied. Clearance officials should not become "judges", on a case-by-case basis, as to which "petitions" should be granted. Only a system of clear-cut, widely disseminated notices of procedure can ensure harmony between clearance officials and the shippers and receivers of goods. Inter-governmental requirements related to trade should be coordinated at the highest level, then incorporated in instructions published for the information of shippers, receivers and clearance officials alike. Once clear,

uniform procedures are laid down, clearance officials at all ports can make responsible decisions on the spot.

4) Administration of Cargo Movement

There is a national consensus that improving the regulation of trade is a necessity. Yet it must be said that some of the recent measures with that aim have not been implemented effectively. At the level of application, there has often been no change in the practices that create the problems. The Japanese Cabinet and other senior officials have promoted the opening of the Japanese market through their endorsement and policy initiatives. What has often been lacking is the follow-through needed to realize the procedural improvements that market-opening requires. The slower progress at administrative levels is explained in part by the authority possessed by government officials in the eyes of the Japanese public. But this awe in which administrative-level officials are held and the wide discretion they possess in decision-making must be diminished, in the interest of free trade.

Japan is justly proud of its low tariffs. But a few days' delay caused by cumbersome administrative procedures can discourage importers and impair trade as surely as high tariffs would.

Free trade calls for both low tariffs and simple, efficient clearance procedures. In Japan, many agencies are involved in trade regulation, but the customs authorities are the principal agents of trade administration. All other agencies must coordinate final clearance with the customs authorities for cargoes that fall under the Customs Law. At present, upon request by any officer of any agency, customs can hold cargo — thus restricting the freedom to trade.

To improve entry administration to a level of openness and efficiency befitting Japan's leading role in the advocacy of free trade, TSG recommends a number of specific changes in law, regulations and practice. Incorporating all such improvements in the provisions of law is the ideal approach to changing administrative practice. However, it is recognized that in Japan there are often means of realizing such changes short of amending the underlying law, with the same result and perhaps less difficulty.

TSG's recommendations, outlined below, mainly involve changes in the Customs Law and the Cabinet Order for Enforcement of the Customs Law, or changes in practice that could readily be realized under present provisions of the Law or the Cabinet Order. At the end of each recommendation, the relevant section of the Law or Cabinet Order is indicated in parentheses for reference. Where actual amendment of Law or Cabinet Order is required, the reference is marked "amend".

(1) Fundamental Purpose of Controlling Cargo Movement

Japanese law and practice should reflect the principles of free trade and lead to internationally accepted procedures for expeditious movement of cargo. These procedures

should provide for reasonable efforts to enforce laws that protect society while avoiding interference with the flow of trade. This is in line with the aims of the Foreign Exchange and Foreign Trade Control Law, Art. 1, and the Criminal Procedures Law, Art. 1. (amend Law, Art. 1)

(2) Separation of Cargo Identification from Law Enforcement

Cargo identification should be expedited and proceed independently from the longer, more complex law enforcement procedures.

a) Elimination of export/import permit system

Except for a prohibited item, identification and reporting of cargo should be based solely on export/import declaration and should not interfere with expeditious cargo delivery. (amend Law, Art. 67)

b) Pre-clearance

A system should be introduced whereby export/import declaration would be accomplished before arrival of cargo. (amend Law, Art. 67-2 and Order, Art. 59-3)

c) Post-liquidation of duties, etc.

For verified residents or those who have deposited a blanket term bond, a post-liquidation system for customs duties and import excises should be introduced. A one-month period should be set for liquidation of these charges. (amend Law, Art. 72, 73)

(3) Equipment and Materials Used in International Traffic

Procedures for handling and movement of equipment and materials used by international carriers should be governed by legal requirements set especially for these items, since commercial cargo procedures interfere with expeditious movement of the working tools of the transport industry. Items to be controlled under this new provision include replacement parts and consumables for ships and aircraft, stores, unit load devices and ground support equipment. (amend Law, Ch. 2, and Order, Art. 1-2)

a) Loading of consumables for ships and aircraft

The permit system for loading of consumables used by ships and aircraft should be replaced by a simple reporting system. (amend Law, Art. 23)

b) Movement of aircraft parts

Movement of parts for maintenance of aircraft should be entrusted to the airlines, including export, import, storage and transfer between storage points within Japan. (Law, Art. 2; amend Order, Art. 1-2)

c) Ground support equipment

Ground support equipment used within airport facilities should not be considered as imported goods. (Law, Art. 2; Annex 9 to Convention on International Civil Aviation [Chicago Convention])

d) Transactions of containers, etc.

Control of containers, pallets, igloos and other unit load devices should be entrusted to the carriers concerned. (Law, Art. 2; amend Order, Art. 1-2)

(4) Bonded Transactions

The rigid distinctions between bonded shed, bonded warehouse, bonded factory, licensed factory, etc. should be discontinued. In each place where a cluster of such facilities exist, the facilities should be controlled as a single entity. (Integration of all bonded-item provisions in Law, Ch. 4 and Customs Tariff Law, Art. 15, 17)

a) License period

All bonded areas should be licensed for a period of 10 years, as already provided in law. Licenses are presently effective for only two or three years. (Law, Art. 42, 55, 62)

b) Designation of bonded areas

Designation of bonded areas should be in accord with the requirements of the users. (Law, Art. 42, 50, 63, 99)

c) Bonded areas for export

In line with generally accepted international practice, bonded export facilities should be eliminated. Sorting and holding areas used by international carriers should not be considered as storage or warehousing facilities within the context of the Customs Law as it relates to warehousing. (Law, Art. 31; Order, Art. 26)

d) Bonded transportation

The permit system for bonded transportation should be discontinued and a simple report system introduced for verified residents and resident companies. (Law, Art. 99; amend Art. 63)

e) Retention of long-storage shipments

Long-storage shipments awaiting government action should be kept in government warehouses, to minimize the losses incurred by the importer when administrative decisions are delayed. (Law, Art. 79)

(5) Customs Office Working Hours

Customs clearance should not be restricted to "normal" working hours. The system of overtime permits should be substantially improved. (Law, Art. 19, 33, 98, 99)

a) Customs office hours

"Customs office hours" as provided for in the Law should be recognized as necessarily different from the office hours of other government agencies, and should be set according to the nature of each activity, such as aircraft/ship control, cargo identification and law enforcement. (Law, Art. 98; amend Art. 19, 33)

- b) Loading/unloading of scheduled flights and voyages
The permit system for overtime loading/unloading for scheduled flights and voyages should be discontinued. (amend Law, Art. 19, 33)
 - c) Clearance of non-commercial items
Clearance of unaccompanied baggage, company materials, gifts, low-value items and other non-commercial items should be carried out on a round-the-clock basis, including holidays. (Law, Art. 98)
- (6) Customs fees
- a) Nature of customs fees
National policy regarding customs fees should be clarified. Assessment to defray inspection cost should be discontinued and such cost should be considered a public expense. (amend Law, Art. 100)
 - b) Methods of payment
For verified payments or for those who have deposited a blanket term bond, a periodic, post-liquidation system should be introduced. (amend Customs Fee Cabinet Order, Art. 16)
- (7) Statistics
- a) Burden of compiling statistics
The burden of compiling statistics is clearly a responsibility of the government, and should not be imposed on the declarants. (Law, Art. 102)
 - b) Cargo flow and statistics
Cargo flow should not be hampered simply to facilitate the collection of statistical data. (Annex 9 to Chicago Convention, Para. 4.39)
- (8) Computerization
- Integrated computerization initiated by customs authorities should be recognized as an important means of facilitating present procedures, and for no other purpose. (Annex 9 to Chicago Convention, Ch. 4, Sect. B)
- (9) Coordination of All Clearance Matters
- a) Integration of other agencies' procedures
In the enforcement of Japanese laws regarding movement of international cargo, requirements of all agencies should be incorporated into customs procedures, with customs officers *alone* empowered to stop or delay the flow of cargo. In any case where an agency believes that cargo must be detained for the public good, the requesting agency must show reasonable cause to suspect that the shipment is dangerous or illegal. (This requires amendment of several Ministry Establishment Laws.)
 - b) Limitation of Customs' competence
The reporting systems provided in other laws should not be allowed to constitute a *de facto* permit system

in the provisions of Art. 70. (e.g. Food Sanitation Law, Art. 16)

- c) Full acceptance of international rules
In carrying out the international regulations for facilitating cargo movement (Kyoto Convention [Customs Cooperation Council]) and Annex 9 to the Chicago Convention, all agencies and administrators at all levels should follow the spirit of the regulations.

Agreement on Import Licensing Procedures (Import Licensing Code)

The GATT Import Licensing Code is concerned with the procedures for import licensing, not with the government policy behind them. Its aims are to simplify these procedures and to make them clear and understandable to all concerned. The Code also calls for procedures for consultation and settlement of disputes.

Japan has yet to take any substantive action to comply with the new Code. Its implementation by Japan, TSG believes, is a key point in alleviating trade friction. The Foreign Exchange and Foreign Trade Control Law, as amended in 1979 and effective in 1980, contains excellent provisions regarding import licensing that require immediate and sincere implementation.

Particularly serious problems raised by present Japanese practice are described below, along with TSG's recommendations for eliminating them.

1) Declaration of restrictions by the Cabinet

At present, import restrictions seem through interpretation to be added or deleted at the discretion of the Japanese trade bureaucracy. To ensure free trade, the highest level of government should take positive action to prevent lesser authorities from instituting practices that in any way impede the flow of trade. Now, tariff rates are determined by the Diet as amendments to the Customs Tariff Law. Import quotas should be decided at a level no lower than the Cabinet and the regulations for their implementation should be contained in Cabinet Orders that are clear in their intent to support national policy. (Law, Art. 52)

2) Restrictions resulting from other national policies

The current import quota list includes various items that have no bearing on foreign trade policy or protection of the national economy. Items such as firearms and endangered species should be deleted from the import quota list and dealt with under the appropriate laws.

3) Residual import quotas

Residual import quota items including beef and oranges should be liberalized within a specified period. Meanwhile, import quotas should be steadily increased with the goal of complete liberalization always in mind.

4) Administrative expansion of the import quota list

Given Japan's economic standing in the world, the number of residual commodity items on its import quota list is large. Moreover, the published list of items under the import quota system has often been expanded by administrative interpretation. For example, a commodity containing any ingredient or material on the quota list is often regarded as the ingredient itself. A foodstuff containing milk is deemed to be a "food preparation mainly containing milk". Even a foodstuff containing butter is so regarded. Classification of imported food products should be based on the major component of the product, not on minor ingredients.

5) Restrictions on domestic use of allocated imports

The Foreign Exchange and Foreign Trade Control Law and the Cabinet Order for its enforcement allow administrators to impose conditions on importation. Import quota authorities often impose additional restrictions on imported materials regarding domestic processing. This practice tends to defeat the intent of the import license and should be discontinued.

6) Method of allotting quotas

There should be much greater transparency in the method of allocating quotas. A quota allocation is a privilege given by the government to a private entity. All applicants should therefore be on an equal footing in competing for quota allotments, as is true for public tenders.

The "Agenda for Action" published by the Japan-U.S. Businessmen's Conference in July 1983 made the innovative proposal that "Japan improve the administration of its quotas by making them transparent and introducing elements of the market mechanism, such as the auctioning of licenses for obtaining quota allocations". Such a system would at least reveal the actual quotas currently held by trading companies and others — information that is not now made public. This would serve either to confirm or to lay to rest any suspicion that quota allocations are being held by Japanese entities which are not using them, either because they consider it too difficult to reinstate an allocation if needed in future or to protect domestic production by holding down imports to the extent of the quota allocation held.

In addition to the import quotas discussed above, which place a limit on the amount that can be imported, Japan also applies some tariff quotas, which provide a two-tier system of customs duties. Quantities up to the quota limit enter at one duty level and further quantities are assessed a higher rate. This system does not place an absolute limit on imports, but it does place some importers in a less competitive position. TSG asks that the method of allocating the lower rates be made open and transparent.

Foreign Exchange and Trade Matters Outside the GATT Import Licensing Code

In some areas, the revised Foreign Exchange and Foreign Trade Control Law has led to effective liberalization. In general, almost all individual foreign exchange settlements have become free of government control when made through authorized foreign exchange banks. However, extensive transactions outside the banking system have created a global business network of settlements through credit and debit accounting. These transactions still require case-by-case government approval in Japan — a procedure that should be replaced by retroactive blanket reporting of transactions.

Export controls are another problem. At present, more than 200 items require export licenses. According to the law, such export restrictions shall be restricted to those necessary for maintenance of the balance of international payments and the sound development of international trade or the Japanese economy. Many of the items now controlled do not seem to fit these provisions.

Moreover, exporters are now required to report each shipment (with some exceptions) and submit an invoice to MITI through customs, in addition to those documents already provided to customs authorities. When they make foreign exchange transactions with authorized foreign exchange banks, they are required to submit an "export report" form to such bank after the export is made, attaching the customs certificate for each export shipment. The export control authorities should either obtain the information they need directly from customs or investigate exporters on a sampling basis.

Government Procurement Code; U.S./Japan Agreement on Telecommunications Procurement

The GATT Government Procurement Code came into force January 1, 1981. A separately negotiated bilateral pact, the U.S./Japan Agreement on Telecommunications Procurement, came into force at the same time.

The GATT Code, as it applies to Japan, covers procurement by "agencies and entities" of the Japanese government, including quasi-governmental corporations like Nippon Telegraph and Telephone Public Corp. (NTT). However, NTT procurement of "public telecommunications equipment" is specifically excluded from Code coverage. (Defense Agency purchases of military goods and Japanese National Railways (JNR) purchases of "materials connected with operational safety of transportation" are also excluded from Code coverage.)

The U.S./Japan Agreement thus covers NTT procurement of telecommunications equipment not covered by the Code.

Japan implements both the GATT Code and the U.S./Japan Agreement on an MFN (most-favored-nation) basis. For this reason, suppliers in all countries to which Japan extends MFN treatment are eligible to bid, whether these countries are signatories to the GATT Code or not.

1) Japanese Government Procurement under the Code

The Japanese government has generally conformed to the transparency requirements of the Code. Notices of intent to accept tenders are published in *Kampo* (the *Official Gazette*) in the form required by the Code. There have been some problems related to the prequalification requirements imposed by government agencies, but an appeal to the Ministry of Foreign Affairs has usually resulted in foreign firms being allowed to prequalify after the deadline date for domestic suppliers.

In 1983, NTT began accepting English-language tenders and providing documents in English. It has also opened "windows" for receipt of documents in New York, Los Altos (California), London and Geneva. This initiative has greatly reduced the reluctance of overseas suppliers to enter NTT procurement bidding.

The most serious difficulties for potential overseas suppliers have resulted from practices in which the Code allows the tendering government some latitude. For example, the 30-day *minimum* period for notice of procurement prescribed by the Code is in fact the *maximum* allowed by most Japanese government agencies. The Code also permits reduced notice periods for items of a "recurring" nature. Several agencies make a practice of announcing their annual requirements of such items with the first tender of the fiscal year, then setting deadlines of 10 days for the rest of the year.

JNR, for example, publishes the approximate yearly requirement for a "recurring" item at the start of the year, works the residual quantity down as the year goes on and then publishes at year-end the following fiscal year's requirements. In this way, JNR is never obliged to give more than a 10-day notice of procurement. This restricts excessively the opportunities for overseas bidders. In theory, it should be possible for an overseas supplier to have a local agent monitor notices and submit tenders by prior agreement. In fact, few if any suppliers have been able to work on that basis.

The Code also allows latitude in the acceptance of tenders in GATT languages (English, French and Spanish) and in acceptance by "Telex, telegraph or telecopy" (Art. V 14[a]). No Japanese government agency other than NTT has been willing to accept tenders in English or by Telex, telegraph or telecopy.

Many competent foreign suppliers are eliminated from competition by the practice of assigning "grades" to suppliers on the basis of their financial strength. Factors such as Paid-in capital, annual turnover, and value of manufacturing facilities are used to classify suppliers. A high percentage or

tenders are limited to Grade A or Class 1 bidders. This practice effectively reserves many supply opportunities for large companies.

Moreover, certain products purchased by government agencies have never been advertised for bid. For example, the Ministry of Health and Welfare (MHW) buys about twice the number of X-ray devices purchased by the Ministry of Education (MOE). Unlike MOE, MHW does not publish its tender notices for X-ray film. Both Ministries operate extensive facilities that require a wide range of maintenance chemicals — cleaning compounds, sanitary chemicals, boiler-water and cooling-water treatment chemicals and the like. Yet neither Ministry publishes bid notices for any of these products. In fact, no Japanese government agency has yet done so.

2) NTT Procurement under the Code and the U.S./Japan Agreement

Overseas penetration of Japan's government procurement market under the Code has fallen far short of expectations. The conspicuous exception has been NTT procurement. NTT's combined purchases from U.S. suppliers for the first three years of the Code and the Agreement were: \$14 million in 1981, \$40 million in 1982 and \$140 million in 1983.

The U.S./Japan Agreement was renewed in January 1984. It is hoped that the U.S. share of procurement orders will continue to expand at an encouraging rate. One should note, however, that the bulk of the purchases in 1983 were contracted during an NTT buying mission to the United States. One of the mission's purposes was to prevent the year's results from being so poor that the United States would decide not to renew the agreement for its second three-year term. It will take continuing cooperation by U.S. suppliers, the U.S. government and NTT if 1984 sales are to maintain the same level as in 1983, let alone increase.

The revised Agreement contains some new provisions and improvements that should improve overseas access to NTT procurement. They include the following points:

- a) Continuation of NTT market-opening measures initiated in 1983, such as acceptance of documents and tenders in English, availability of documents at New York, London and Geneva "windows", and publication of lists of NTT programs (NTT opened its California "window" in June 1984.)
- b) Procurement practices more in line with international practice
- c) In regard to R&D, access provided by NTT for foreign firms and treatment of them no less favorable than that provided to Japanese firms, including access to NTT Laboratories
- d) No discrimination against U.S. suppliers in NTT leasing practice

The U.S. side also included a set of informal goals in the revised Agreement: that a significant sales volume should be achieved, especially in high-technology goods, and that long-term relationships should be developed.

It is uncertain whether the revised Agreement will be binding on NTT after its expected reorganization into a semiprivate company in 1985. There have been bilateral discussions on this question, but no understandings have yet been reached. TSG hopes that there will be no impairment of foreign access to NTT procurement as a result of privatization. This matter is discussed further in Chapter 5.

MARKET-OPENING PACKAGES

Following its acceptance of the GATT Codes that emerged from the Tokyo Round multilateral trade negotiations, the Japanese government has initiated another approach to trade problem-solving. Since the beginning of 1982, a series of five "packages" of market-opening measures have issued at Cabinet level. Their contents range from changes in existing policies and regulations to legislative proposals to amend restrictive features of Japanese law. Their aims have been to increase imports of manufactured goods and some agricultural products and to bring trade-related administrative practice closer to international norms. Significant features of these five packages and their effectiveness in practice are discussed below.

1) First and Second Packages: 1982

Near the end of 1981, an *ad hoc* committee established by the Liberal Democratic Party and led by former Minister of International Trade and Industry Masumi Esaki reviewed current trade complaints and allegations of non-tariff barriers from foreign sources. The Esaki Committee recommended 67 remedial actions, which were adopted as a package in January 1982 by the Ministerial Council on Economic Measures — the members of the Cabinet most directly concerned with economic and trade policy.

The Administrative Management Agency (AMA) began a special investigation of import procedures. Meanwhile, the government agencies affected took their own measures to comply with the market-opening practice, effective April 1982.

As a means of monitoring the effectiveness of these measures, a new, government-wide channel for foreign grievances was established as the final measure in the package. Called the Office of Trade Ombudsman (OTO), its board brings together vice-ministers of 11 ministries and agencies involved in Japanese trade regulation. OTO's function is trade troubleshooting: providing both a hearing for NTB complaints and liaison among government agencies with the goal of prompt processing and clear resolution of grievances

by the appropriate agency. OTO's operation and effectiveness to date are discussed in the final section of this chapter.

Customs authorities announced a five-point plan to comply with the market-opening package:

- a) "After permit examination" system
This new system is an important exception to the rule requiring all necessary procedures to be completed before issuance of import permits.
- b) Simplified examination procedures
Procedures for examination of routinely imported goods were to be streamlined.
- c) Minimization of documentary requirements
Rules were established to relieve importers of excessive documentation.
- d) Selective physical inspection
Physical inspection for customs purposes would be performed on a more selective basis under a new administrative policy.
- e) Uniformity of tariff classification
A classification center was established at Tokyo Customs to ensure uniformity of tariff classification. A year later the advance ruling system was introduced, whereby importers may obtain advance rulings from Customs on tariff classification and rate, statistical code number, excise tax and the like. These written rulings, with some exceptions, are binding on customs officers at the ports.

By all reports the documentary burden was generally lessened by the new procedures. However, explanatory letters, self-inspection reports, etc. are often demanded still by customs officials before cargoes can be moved. There is, in fact, growing disappointment with the "improvements" in customs procedures. Declarants hesitate to discontinue the use of documents "no longer required" by the central customs authorities. Several documents remain as great a burden as before. The wording of some of the measures is vague, and their on-the-spot implementation becomes a matter of interpretation.

In the area of food products, the market-opening package led to several changes in import regulation by the Ministry of Health and Welfare (MHW):

- a) Foodstuffs in quantities of 10 kg or less would be regarded as non-commercial shipments.
- b) Raw salt, raw distilled alcohol and raw sugar or molasses would not be regarded as foodstuffs.
- c) Importers of whisky and other distilled spirits or of government-purchased rice or barley are entitled to prompt return of the import-reporting certificate.

- d) For fresh foodstuffs, import reporting certificates may be accepted prior to arrival of the shipment.

Measure (a) was welcomed, but food sanitation officers continue making zealous efforts to determine if these small shipments are really non-commercial. Thus the measure is hardly effective. Measure (d) is also ineffective, since the certificates are not returned prior to arrival of shipments and, by administrative agreement with MHW, Customs does not allow importers to take delivery from the port.

In May 1982 the Cabinet issued a second package of market-opening measures, concerned mainly with tariff rate adjustments. Tariffs were eliminated for 96 industrial products and reduced for 102 industrial and 17 agricultural products.

2) Third and Fourth Packages: 1983

In January 1983 the third package of measures was announced.

Key points were:

- a) Reduction of tariff rates on 28 industrial and 47 agricultural products (including tobacco, chocolate candies, biscuits and brandy)
- b) Expansion of import quotas for six items (including tomato juice and tomato ketchup, but excluding beef and oranges)
- c) Expansion during 1983 of the number of retail outlets allowed to handle imported tobacco products to include all outlets so desiring in major cities
- d) A second special investigation of import procedures by the Administrative Management Agency
- e) Strengthening of OTO
- f) Improvement of import testing procedures, including acceptance of certain test data generated overseas for veterinary drugs, feed additives, high-pressure containers and electrical appliances (discussed in section on Standards Code implementation)
- g) Improvement of standards and certification systems

The Prime Minister personally directed the Cabinet to review laws and procedures pertaining to standards and certification systems. In May 1983 amendments to 16 existing laws were enacted as a result. The object was to ensure nondiscrimination between Japanese and foreign suppliers in applying for and obtaining certification of goods; and to accord imported goods substantially equal treatment to that given domestic goods with respect to product testing. The effect of these amendments is examined in the 'GATT Codes Implementation' section of this chapter.

In AMA's second special investigation, meanwhile, more than 2000 trade organizations and trading firms were queried about problems they actually encounter. In June 1983

AMA recommended improvements in 10 areas, including discontinuation of plant quarantine inspection at transit airports, use of blanket overtime loading/unloading permits and extension of working hours of MHW's food sanitation office. The recommendation about plant quarantine was fully implemented by the Ministry of Agriculture, Forestry and Fisheries. The customs authorities have established a blanket request system for overtime applications. The procedures involve so much advance notice, however, that the system cannot be implemented. MHW, meanwhile, has taken no apparent action to extend the office hours of its food sanitation office.

The fourth market-opening package, issued in October 1983, combined measures to increase imports — mainly tariff reductions — with others intended to stimulate the domestic economy. Tariff rates were reduced for some 40 items. Import financing for manufactured goods via low-interest Export-Import Bank loans was also introduced.

3) Fifth Package: 1984

The latest market-opening package was announced in April 1984. Specific measures of note include:

- a) A statement of intent to allow government and government-related agencies and private firms the option of purchasing space satellites from foreign suppliers where purchase from Japanese sources is not necessary for domestic development of technology under Japan's space development policy; and to allow NTT the same option regarding communications satellites
- b) Intent to take follow-up steps based upon the Japan-U.S. Policy Statement on Energy Cooperation, issued in November 1983 by the Japan-U.S. Energy Working Group
- c) Acceptance of test data from suitable foreign testing organizations for certification of a range of products (some previously announced); intent to issue clear guidelines for each certification system affected by the end of 1984 (see section on Standards Code Implementation)
- d) Elimination of tariffs for 7 items and reduction of tariff rates for 60 others
- e) Expansion of import quotas for a range of import-restricted agricultural products (including high-quality beef, fresh oranges and orange juice over a four-year period, as negotiated with the U.S. government shortly before announcement of the fifth package)
- f) Removal of quota limits for six categories of agricultural products (including prepared or preserved pork products, high-test molasses and other sugars, a number of fruit juices, purees, pastes and pulp, and certain food preparations containing added sugar)

- g) Broadening of the Charter of OTO to include acceptance of grievances related to direct foreign investment in Japan

OFFICE OF TRADE OMBUDSMAN

The Office of Trade Ombudsman (OTO) was established in 1982, by decision of the Ministerial Council on Economic Measures within the Cabinet, as a central avenue of appeal regarding abuses of certain kinds in trade administration. Headed by the Deputy Chief Cabinet Secretary (Administrative), OTO's board includes vice-ministers of the 11 ministries and agencies involved directly in Japanese trade regulation. Each of these ministries and agencies in turn maintains a reception office for "grievances related to import inspection procedures", though complaints may also be filed directly with the OTO secretariat in the Economic Planning Agency. Since 1983, OTO also accepts requests and complaints filed by proxies for business firms — embassies and agencies of foreign governments, foreign chambers of commerce and similar organizations.

As a trade problems troubleshooting group, OTO serves as a clearing house for grievances, directing them to the appropriate agency and level for action and monitoring progress in reaching some conclusion. OTO rules call for the responding agency to make a clear statement of reasons for the determination made in each case.

OTO has been a valuable tool in tracing trade problems to their root. Its function, however, is not that of "ombudsman" in the usual sense of the term: "a public official appointed (1) to investigate citizens' complaints against government agencies that may be infringing on the rights of individuals, (2) to recommend a solution and (3) to enforce the solution." OTO has no authority to make changes in trade administration.

In practice, OTO's secretariat in the Economic Planning Agency receives a grievance and relays it to the OTO reception office in the ministry or agency involved in the case. It then passes to the middle-level official responsible for resolving the matter.

At an estimate, perhaps two-thirds of the cases brought to OTO and determined to date have been resolved to the satisfaction of the complainant. (TSG does not consider an OTO case resolved if, as not infrequently happens, the final report states that "the problem was explained to the party and he understood".) Some OTO cases have led to changes in administrative procedure. Even in cases where this did not occur, the OTO review process itself has had the effect of educating the complainant about existing administrative procedures.

One significant finding of OTO is that, in about 10% of the cases brought, no trade barrier in fact exists. The customs

broker has been misinformed or was not aware of current regulations and thus misinformed the importer. This problem may lie partly in the reluctance of many in Japanese business to question the rulings of a government official. The customs broker's relations with customs officers are more important to him than his relations with any given customer. When the customer is foreign, the broker may be even less inclined to risk offending the customs officers. OTO reports of such complaints imply that the government is not responsible for these cases. Yet the government licenses customs brokers and therefore is responsible for seeing that they are well-informed and are advising the public correctly.

Some foreign businessmen have brought cases outside the jurisdiction of OTO, then complained that OTO was unable to resolve them. Its mandate is limited currently to problems related to the import of goods and since April 1984, to procedures for direct foreign investment in Japan.

Some firms have been unwilling to bring grievances to OTO for fear of retaliation or of disturbing their established relationship with the regulatory agency in question. One company, for example, found that its complaint about a ruling simply circulated through OTO and back to the desk of the official who had made the ruling originally. This official expressed his displeasure in blunt terms to the company, which must continue dealing with him about the disputed ruling.

A firm's reluctance to approach OTO will in many cases depend upon the degree of its involvement in Japan. If it has many local offices and numerous contacts in various ministries, it could well be counter-productive to appeal to OTO. A firm that has not yet gained a foothold in Japan, however, has little to lose in presenting a complaint and may find in a positive ruling the opening needed to reach the Japanese market.

Some measure of OTO's effectiveness can be gained from the results of a February 1983 survey made by the Administrative Management Agency (AMA) of the Office of the Prime Minister. AMA surveyed 1447 firms whose business involved imports to determine how many had past complaints about import inspection procedures. Some 62% of these firms had had such problems. Only about one-third of the companies encountering problems, however, had filed a grievance with OTO. The reasons given by the firms that did not file grievances:

- Filing compliant does not help resolve the problem (58.1%)
- Do not know how and where complaint will be handled (17.8%)
- Fear retaliation by the administrative authorities (16.3%)

TSG believes that OTO has more potential for assisting in the settlement of trade problems than it is generally credited with, but that it needs more authority to negotiate settlements.

At present it is little more than a "window" for receiving cases, maintaining records and reporting results. However, TSG has been advised that all rejected grievances are referred back to the Esaki Committee for final review.

It also needs authority to deal with problems involving

trade in services and problems arising beyond the import stage of foreign goods marketing in Japan. Finally, it is important that the Japanese government take steps to eliminate the perception that bringing a complaint to OTO can result in retaliation by a government agency.

Chapter 3

PROBLEMS IN SPECIFIC PRODUCT AREAS

INTRODUCTION

This chapter deals with the respective trade problems of eight groups of manufactured or processed products: automobiles, pharmaceuticals, medical supplies and equipment, cosmetics, agricultural chemicals, forest products, tobacco products and food products.

Trade problems regarding electrical appliances, discussed in the 1980 TSG progress report, centered on Japanese product standards and testing procedures for such items. These problems have largely been resolved, and no additional barriers have been identified by TSG. In other product areas, either there are no significant trade barriers or the companies encountering such problems have not come forward with them.

Some of the barriers described in the following reports are instances of the broader problems cited in the previous chapter and demonstrate the impact of generic problems in specific product areas.

Although the extent of trade friction varies among the industries covered here, a common theme is apparent. In almost every case, real progress has been made during the past four years in removing trade barriers, although substantial problems remain to be solved.

These reports, originally drafted by American participants, were reviewed by Japanese members whose corrections and suggestions are reflected in the final text. It is fair to say that each report represents the consensus viewpoint of the TSG membership.

AUTOMOBILES

In 1983, Japan exported 1,865,219 automobiles to the United States and imported 2,646 U.S.-built automobiles. This disparity is due to a number of factors, including a decline in Japanese consumer interest in U.S. automobiles, which must be recognized and dealt with by both the United States and Japan.

The Japanese government has taken a number of steps to make the market more accessible to foreign vehicles. A lowering of barriers to foreign investment in 1971 permitted U.S. firms to acquire shareholdings in Japanese automobile manufacturers. In 1973, the commodity tax on automobiles with engines larger than 2000 cc displacement was reduced from 40% to 20%. (It was raised to 23% in 1984.) In 1975, the tariff on imported automobiles was abolished and a program was launched to improve the type approval/certification system of the Ministry of Transport (MOT). The revised system allows vehicles destined for the Japanese market to be inspected in their country of manufacture, and makes possible an earlier introduction in Japan of new models from foreign manufacturers.

Since 1979 MOT has posted technical personnel in the New York office of JETRO (Japan External Trade Organization) for better communications with U.S. automobile manufacturers. From 1982, automobiles imported in small numbers have been eligible for a simplified examination procedure that is faster and less expensive than the new type notification system. The number of units per type (model) eligible for this 'low-volume exemption' was raised in 1983 from 100 to 300 units per type per year, and further, to 500 units in July 1984. In October 1983, MOT also took steps to ease its type designation system¹⁾ and simplified some items in the vehicle safety standards.

Some of the other measures which have been taken by the Japanese government to promote automobile imports are: dispatch of inspectors overseas to inspect sample automobiles, acceptance of certain test results from official testing institutes abroad or test results based on foreign standards comparable to those of Japan, and postponement of new exhaust emission and noise regulations.

However, representatives of U.S. automakers in Japan still feel that barriers remain, requiring further action. With the cooperation of the Ministry of International Trade and Industry (MITI) and the Economic Planning Agency (EPA), U.S. automakers in Japan are continuing discussions with the

¹⁾ A new model can receive type approval by either of two procedures — new type notification or type designation — as the manufacturer chooses. In the former system, each unit is checked directly by a public agency in Japan. In the

latter, the manufacturer inspects each unit on behalf of the government and is subject to government supervision of inspection performance.

Japanese government through two channels: MOT and the Ministry of Finance (MOF).

First Channel: Ministry of Transport

The focus of discussions with MOT has been Japanese certification, registration and homologation²⁾ requirements. Talks have ranged from proposals that the Japanese government accept U.S. certification requirements as equivalent to its own (which in some points are less stringent than U.S. requirements) to proposals that certain safety and anti-pollution requirements be eliminated or that alternatives be accepted.

Japanese safety and anti-pollution standards are not directed specifically against imported vehicles. Yet these requirements often have a considerably greater impact on imports than on vehicles produced in Japan. This is due to both the extra work and time involved in adapting imports to suit Japanese requirements wherever there is a difference between the standards of the two countries, and to the resulting effect on price. TSG recognizes that the Japanese regulatory system is based on a greater degree of government responsibility for product approval than is the American system. TSG also feels that, as a general principle, manufacturers should adapt their products to local requirements when exporting. Nevertheless, TSG believes that U.S. requests for concessions in this area, when reasonable, should be given full consideration by the Japanese government.

The proposals brought to MOT's attention during informal discussion meetings with U.S. automakers in Japan, and the current status of these issues, are outlined below.

A. Certification

1) Acceptance by the Japanese government of U.S. Federal Motor Vehicle Safety Standard certification in place of the equivalent Automobile Type Approval Test Standards of Japan's Traffic Safety and Nuisance Research Institute (a MOT agency), so as to reduce the massive documentation now required.

Status: Some progress. MOT recognizes equivalent standards of broad application, but test results submitted must conform with Japanese test documentation. MOT believes it cannot rely solely on the test judgment of the applicant.

2) Acceptance by the Japanese government of performance

data for new products and equipment (such as electronic digital speedometers) in place of the detailed engineering information now required.

Status: Some progress. MOT will attempt to minimize such requirements, but will continue to request such engineering information as it considers necessary.

3) Acceptance by MOT of sample vehicles of a representative model within a family of models for witnessed testing and certification, rather than requiring sample vehicles of every model in the family.

Status: Considerable progress. MOT is now accepting representative models, thereby reducing the total number of vehicles that must be presented to MOT and also reducing the total workload of certification. It should be noted, however, that neither this concession nor the definition of representative automobiles was put into writing by the authorities.

B. Vehicle Registration

After the manufacturer receives vehicle type approval, dealers must present each unit for inspection prior to registration to ensure compliance. Appointments in advance are required. (In addition to imported vehicles, Japanese automobiles produced in small numbers and modified vehicles must undergo these inspections.) Dealers encounter costly delays in registering imported vehicles as a result. It has been proposed that MOT adopt a sampling technique and eliminate individual inspections of every unit imported.

Status: MOT's response was the October 1983 revision of the type designation system. The announced intent was to make this approach to type certification procedure, in which individual vehicle inspection is conducted by the manufacturer rather than by a public agency in Japan, more readily usable by overseas manufacturers. The principal revisions were: (a) acceptance of durability data instead of the previously required presentation of two test vehicles (one each for safety and exhaust emissions testing) for durability trials in Japan; (b) acceptance of data obtained by overseas automobile manufacturers in accordance with foreign test procedures that are nearly equal to the corresponding Japanese procedures; and (c) simplification of application documents, such as elimination of strength calculations for vehicle bodies and parts from the submissions required.

C. Homologation

MOT has agreed only to discuss homologation matters

²⁾ 'Homologation' refers to the entire process of adapting vehicles to make them eligible for sale and registration in Japan. The same term is sometimes used as the equivalent of "granting of Type Approved or Type Certified status", which includes completion of such steps as certification

documentation, test reports, witnessed tests and their results, subsequent vehicle modifications, and results of pretesting and/or tests witnessed by designated MOT officials.

informally, for the sake of information exchange and not in the sense of negotiation. Examples of the proposals outstanding in the area of homologation are summarized below.

1) Elimination of the requirement to install a separate low-current parking lamp system on U.S. automobiles sold in Japan.

Status: Potential progress. MOT has reduced the number of parking lamps to be lighted to those on only one side of the vehicle. (The parking system test informally requires that the vehicle's battery be able to start the motor after a 12-hour parking lamp test period.) The basic requirement of engine startability, however, has not been clarified technically.

2) Elimination of the requirement for total prevention of light reflection between segments of tail-light assemblies.

Status: Considerable progress. Illustrative samples have been furnished to MOT for study of potential tolerance for light leakage. Potential standards would be applied to both domestic and imported vehicles. Actual test rejection rate, meanwhile, has been significantly reduced, but no scientific measure of the quantifiable limit of light leakage has been made public.

3) Elimination of the requirement for a 30 mm-diameter clear reflective area as a rear reflector. (The vehicle tail lamp provides a larger reflective surface, though it may contain some ornamental design effects.)

Status: Considerable progress. MOT has endorsed a requirement similar to the ECE-R3 rule observed in Europe.

4) Elimination of the requirement for dual speed warning devices — both visual indication on the speedometer and audible indication by buzzer or chime.

Status: Some progress. MOT has eliminated the visual indication requirement.

5) Elimination of heat shieldings in addition to those provided by the manufacturer.

Status: Slight progress. MOT has revised its test procedure, now requiring only a warning device performance test and related temperature measurement.

6) Acceptance of aerodynamic styling as part of vehicle design whether integral or add-on.

Status: Considerable progress. Formerly, aerodynamic styling was acceptable only if an integral part of vehicle design; add-on design such as rear-end spoilers was not accepted. Aerodynamic styling is now acceptable if design and performance meet newly announced construction standards. The vagueness of the requirements, however, continues to cause differences in interpretation. More specific definition is needed.

U.S. automakers in Japan made their most recent presentation to MOT in March 1983. Both short- and long-

term proposals were suggested in regard to certification procedures, exemptions and elimination of certain policies, as well as possible adoption of modified U.S. procedures that would be to Japan's advantage. To date, MOT has made no direct response to that presentation although, as noted above, some new measures have been taken. TSG believes that continuing communication between U.S. automakers and MOT is important and would be useful. TSG also believes the United States and Japan should actively work to establish international standards on regulations for imported vehicles.

Second Channel: Ministry of Finance

Of great concern as well is the matter of the commodity tax levied on automobile sales in Japan, and the effects of the yen/dollar exchange rate on automotive trade.

A. Commodity Tax

Starting in 1979, U.S. automakers have held talks with MOT about problems related to Japan's commodity tax. This tax (23% for large cars, 18.5% for small cars) is levied on automobiles sold in Japan but not on those exported from Japan. U.S. automakers consider the exemption of this tax for exported autos to be, in effect, a significant export incentive, though legal under international trade agreements. TSG notes that while U.S. automobile exports are similarly exempt from American state sales taxes (which range from zero to 7.5%), U.S. cars imported into Japan are subject to acquisition and weight taxes which equal or exceed the state sales taxes foregone. The considerably larger tax exemption for Japanese auto exports gives Japan a significant advantage over U.S. auto exports. The commodity tax advantage is only partially offset by the 2.8% import duty levied by the United States on the FOB value of imported automobiles.

Two additional problems created by the Japanese commodity tax should continue receiving attention:

- As noted above, the commodity tax is higher for larger automobiles (23% on vehicles with engines larger than 2000 cc, 18.5% on those with smaller engines). Most automobiles exported from the United States are in the higher-tax category. It is not claimed that these differential tax rates are intended to discriminate against imports: the commodity tax applies to all automobiles sold in Japan, and the difference in the rates reflects the general policy of progressive taxation in the Japanese tax system. Nevertheless, the effect of the differential rates is to create a disadvantage for most American automobiles in the Japanese market.
- Using CIF value (cost, insurance and freight) as the basis for calculating the commodity tax adds to the price of imported automobiles. Japan says that the intent is not discriminatory. Nevertheless, the effect is a cost disadvan-

tage for imported automobiles, because the basis for calculating the commodity tax on vehicles manufactured in Japan is the cheaper ex-factory price.

Special concessions on the issues discussed above would have a highly favorable impact on U.S. public opinion at negligible cost to Japanese automobile manufacturers, since any resulting increase in automobile imports would likely be quite modest in absolute terms. Despite the steps Japan has taken to make its market more accessible, there has been no significant increase in market share for imported vehicles. New initiatives in a sector where the trade imbalance is so glaringly great would go far toward convincing the American public of Japan's sincerity about opening its market to foreign goods.

B. Yen/Dollar Exchange Rate

Another factor contributing to the automobile trade imbalance between the United States and Japan has been the relative undervaluation of the yen in dollar terms. The reasons behind the exchange rate misalignment are many, and responsibility for introducing effective measures to correct this problem lies on both sides of the Pacific. On America's side, high interest rates, caused by the anticipation of large budget deficits, are an incentive to large capital inflows that boost the value of the dollar. On Japan's side, efforts to liberalize and internationalise the yen should continue, as discussed in the Banking section of Chapter 4.

PHARMACEUTICALS

The United States continues to have a favorable balance of trade with Japan in pharmaceuticals. Yet a number of issues regarding NTBs and other perceived barriers remain unresolved. The attitude of the Minister and other senior officials of the Ministry of Health and Welfare (MHW) in dealing with these issues has been positive. The problem seems to lie in the implementation of new policies by lower echelons within the Ministry.

U.S. pharmaceutical companies in Japan have presented position papers to MHW and have held numerous discussions with its officials in an effort to reach a clearer understanding of the issues. Problems of major concern to foreign pharmaceutical companies are reviewed below, along with proposals made to overcome them and progress to date.

Preclinical Studies

Preclinical studies, the first part of the long process of establishing the usefulness and safety of a new drug, include

research into the drug's biological action and its possible toxicity as determined by tests in animals. Until a few years ago, MHW required that all preclinical studies be conducted, or repeated, in Japan. Then the rules were changed to accept foreign preclinical test data — provided that the data satisfy Japanese regulatory requirements and that they are also the basis for approval of the drug in the other country. MHW continued to require that acute and subacute animal toxicity studies be repeated in Japan, "just to confirm" the validity of the foreign data.

Foreign governments and pharmaceutical firms have pointed out that Japanese acceptance of foreign test data with these provisos has little meaning, because Japan's regulatory requirements are so singular that a separate set of preclinical studies must be conducted in any case to satisfy MHW.

Responding to this criticism, MHW recently announced three changes:

- If preclinical studies are conducted in conformity with GLP (Good Laboratory Practice)¹ standards, the results will be accepted even if they are not part of the data submitted for product approval in the other country.
- Acute and subacute animal toxicity tests need not be repeated in Japan.
- New guidelines are proposed for preclinical studies in an attempt to harmonize MHW requirements with those of other countries.

The proposed guidelines are now being discussed with the Japanese Pharmaceutical Manufacturers Association (JPMA) and foreign manufacturers, and some suggestions from these sources have led to modifications in the guidelines. Although they are still more stringent in some points than are U.S. and European guidelines (such as in the kinds of organs to be examined histopathologically), it is fair to say that the new Japanese guidelines are quite close to those in the United States and Europe.

Another change of MHW policy, made in February 1984 at the urging of JPMA with the endorsement of TSG, made mutagenicity testing more flexible by allowing research workers a choice between tests in animals or tests in laboratory glassware after a certain stage (the Ames test) of the study.

Japanese regulatory practice remains significantly different, however, in the area of reproduction studies. MHW guidelines, for example, divide the period from animal pregnancy to weaning into three stages and specifies limited times within each period for administering drugs in several kinds of testing (fertility, teratology and peri-postnatal studies). By contrast, guidelines widely used in the United

¹ 'Good Laboratory Practice' refers to official standards for the conduct of preclinical studies. Examples of the matters covered by GLP standards are accuracy of dosage, accu-

racy of record-keeping, and completeness and manner of selection of data reported.

States, Canada and Western Europe specify that drugs be administered throughout the gestation period. Unless foreign companies modify their basic testing practice to meet MHW's singular guidelines, they must repeat reproduction studies solely for product registration in Japan.

TSG recommends the establishment of an agreement among MHW, the U.S. Food and Drug Administration and the European Community's regulatory agencies that specifies mutually acceptable requirements for preclinical testing. This would allow a single collection of data to be used for product registration purposes in all of these countries.

Stability Studies

Stability testing of a proposed new drug is carried out to determine if it will maintain its strength and purity during long storage and to confirm that any degradation or interaction products formed over a period of time are within acceptable limits. MHW requires that data from three-year stability tests at room temperature and ambient humidity be submitted with applications for new drug registration.

The principal problem with MHW's stability testing requirements has been one of duplication. Where a new drug is co-developed by two or more companies — the practice usually followed by U.S. and European companies in readying a new drug product for the Japanese market — every company involved has had to conduct stability studies. Such duplication wastes time and materials and needlessly ties up analytical equipment and other facilities of both the sponsoring companies and MHW.

Following several months of discussions between TSG and MHW about this problem, the ministry announced in June 1984 new guidelines for stability studies that will eliminate much duplicative testing. They may also reduce the time required for the application and review process leading to drug registration in Japan. MHW's new guidelines include these key changes:

- Though three-year stability test data must still be submitted, data from just over a year's testing are acceptable when the new drug application is filed, provided these data are confirmed by accelerated (short-term, high-temperature, high-humidity) tests. The three-year data can be filed later.
- For a drug product co-developed by two or more companies, only one firm need carry out a three-year stability study. The data for initial filing can be supplied from this study, while other co-developers need only conduct accelerated tests.
- When identical bulk material is to be used in preparing the final product, only one stability study is required. The final data prepared by one developer can be used for registration by all co-developers.

- If minor revisions of a drug product are proposed, such as changes in the inert ingredients (binders, etc.) or the packaging materials used, an accelerated study will be sufficient for stability testing of the revised product.
- If a drug company wishes to change the country of manufacture of a bulk drug or finished drug product already on the Japanese market, the new manufacturing location would only be required to submit accelerated stability data.

Transfer of Import License

In the past, the license to import a drug product was not transferable from one importer to another in Japan unless the entire new-product registration procedure was repeated, during which time the product must be removed from the market. This problem was ended in 1983 by amendment of the Pharmaceutical Affairs Law as part of an omnibus revision of product standards and certification systems to improve Japan's conformity with the GATT Standards Code. Import licenses are now transferable without re-registration of the drug product, provided that the manufacturer and the location of manufacture remain the same.

Transfer of Manufacturing License

Japanese law stipulates that pharmaceutical manufacturing licenses, which embody product ownership rights, cannot be transferred from one company to another. At its discretion, however, the government may allow such a transfer on a case-by-case basis, with the following restrictions:

- The relinquishing company must officially declare that it will discontinue manufacturing the product.
- The receiving company's application to MHW must include accelerated (six months) stability test data and other data generated by its own staff, in its own laboratories, using product samples which it has manufactured.
- The transfer application will in principle be accepted only for one or two products at a time, and approval requires a period of up to 18 months.
- The transfer application for a drug within its "priority protection" period (six years from its original introduction) must include more complete test data, including results of a long-term stability study. The new regulations on stability, outlined above, will apply.

The disadvantage of these provisions to foreign companies is rooted in the former restrictions on foreign capital investment in Japan. Until 1975, when foreign direct investment in the Japanese pharmaceutical industry was fully liberalized, foreign companies could conduct manufacturing operations in Japan only in the form of a joint venture with a Japanese partner, in which the foreign firm could hold no more than 50%

equity. More commonly, foreign firms licensed the import/manufacture of their drug products to a Japanese firm. Since the time of liberalization, most foreign firms have established their own majority-owned subsidiaries in Japan and have built their own manufacturing facilities, enabling them to register future products in their own name.

During the first few years of such investments, their economic feasibility often depends on the transfer of manufacturing rights for the foreign company's established product line from the former Japanese licensee to the company's own subsidiary. Although transfer of manufacturing licenses is possible on a case-by-case basis, there are three drawbacks in practice:

- Without the full consent and cooperation of the Japanese licensee it is impossible to transfer a license so as to obtain the rights and titles to the licensor's own products.
- It is almost impossible to transfer licenses for recently registered products, due to the data submission requirements for products still within their priority protection period as noted above.
- There is potential for delay since cases are considered individually, without clear-cut, published guidelines.

This matter, a priority issue, has been discussed with MHW in three sessions during the past 18 months, but there has been no progress worthy of note. Stressing reciprocity rather than discrimination, the documents submitted by the U.S. side point out the rational and efficient regulation of license transfers by the U.S. Food and Drug Administration (FDA). TSG wishes to continue discussion of these complex issues in an attempt to reach consensus.

TSG recommends that the regulation of manufacturing license transfer be referenced to GMP (Good Manufacturing Practice) and GLP standards already adopted by the advanced nations. If interpretation of the respective GMP standards accepted in the United States and Japan or differences between these standards is a problem, then the two governments should work to establish a reciprocal protocol covering GMP standards in the field of pharmaceuticals manufacturing.

If verification of compliance with the standards is a problem, inspection of U.S. plants and laboratories by MHW officials, with costs paid by the petitioning companies, would be welcome. There is precedent for overseas dispatch of Japanese government inspectors. The Ministry of Transport, for example, sends inspectors to U.S. and European automobile plants at the request of foreign manufacturers that export vehicles to Japan, and the Ministry of International Trade and Industry has begun sending inspectors to overseas plants of companies seeking JIS (Japanese Industrial Standards) compliance certification of their products.

Appeal Mechanism

The lack of an open forum for appeal of regulatory

decisions regarding pharmaceutical administration continues to be a matter of concern. In contrast to the public presentation and response to questions allowed to pharmaceutical companies in most Western countries in such matters as application for new drug registration, in Japan the entire review process is carried out in private.

TSG believes that the company sponsoring a new drug application should be allowed to present its own case to the First New Drug Investigational Screening Committee, and to hear at first hand any questions raised by the Committee. If possible, the sponsoring company should also be involved in replying to the Committee's questions, since the firm that develops a drug generally possesses the most complete information about the drug.

It should be noted that Japanese and other non-U.S. pharmaceutical companies are free to present data directly to an FDA advisory committee as part of the new drug registration process in the United States, and if needed they may bring expert consultants and other advisors before the committee to help present the information.

Unfortunately, the Japanese pharmaceutical industry has been troubled in recent months by a number of serious irregularities concerning the integrity of new drug test data and with the confidentiality of test data submitted to MHW. The discovery of these violations has led to resignations by key research executives and other officials of several Japanese drug companies as well as resignations and disciplinary action within MHW itself. It remains to be seen whether these discovered violations of present regulations will lead to greater reluctance by MHW regarding their further liberalization.

MEDICAL SUPPLIES AND EQUIPMENT

There has been a significant improvement in the regulatory climate since 1980 for foreign companies that manufacture or market medical supplies and equipment in Japan. Several proposals made by foreign companies in this sector as means of eliminating trade barriers have won the general agreement of the Ministry of Health and Welfare (MHW), which in recent years has shown a spirit of growing communication and cooperation with foreign medical supplies and equipment companies.

The greatest change since the 1980 TSG progress report was published, in fact, has been MHW's demonstrated desire to open channels to the foreign firms operating in Japan and to hear their proposals on regulatory issues. Key regulatory changes made or being considered by MHW that incorporate TSG suggestions are summarized below.

- 1) For purposes of new product registration, MHW now accepts results of non-clinical testing carried out overseas, rather than requiring repetition of these tests in Japan. (Such testing includes electrical safety tests, product

specification tests, chemical tests and the like.)

- 2) Results of clinical testing conducted overseas are being considered for acceptance by MHW for medical devices for which racial differences among patients are irrelevant.
- 3) MHW has introduced a simple, speedy procedure for transfer of a product import license from one importer to another in Japan if there is no change in the product involved, its manufacturing process or the manufacturing location. (Such transfer in the past required a repetition of the new product registration process.)
- 4) When a previously approved product is modified in ways that do not affect its safety or efficacy, MHW now provides an application procedure for partial changes in approved items rather than requiring new product approval.
- 5) MHW is considering the following steps to reduce product registration time:
 - a) Clarifying and codifying regulatory requirements so as to minimize case-by-case administrative guidance.
 - b) Developing a classification system for medical supplies and equipment such that requirements and approval procedures appropriate to each type of product can be applied. This allows faster registration of products of a non-critical nature.
 - c) Informing the applicant within a stated period whether an application is considered complete and, if more information is needed, specifying what is required for MHW to complete its review.
 - d) Making greater use of local-government (prefectural) health offices to approve product applications of certain types, under appropriate guidelines issued by MHW.
 - e) Issuing English-language translations of more of MHW's regulations, manuals and other publications.
- 6) Greater opportunity is now provided for foreign firms in the medical supplies and equipment field to participate in the process of regulatory review and change.

TSG is pleased that MHW now allows foreign manufacturers to make applications for product registration under their own names by assigning a domestic caretaker.

TSG plans to concentrate its future efforts in the sector on two key issues that remain unresolved: manufacturing location transfers and the classification of *in vitro* diagnostic products.

A manufacturer of medical devices may make a given product at plants in more than one country, using identical processes to turn out identical products. At some time after the product is registered and on the market in Japan, it may be advantageous for the manufacturer to supply Japan from a country other than that from which the item was initially shipped to Japan. Currently, MHW requires an application for a partial change for such a change of manufacturing location. Where the product and manufacturing process

remain the same, TSG proposes that MHW provide a faster, simpler procedure for approving changes in manufacturing location.

In vitro diagnostic reagents are chemicals used in laboratory tests for diagnosis of disease, and they do not come into contact with the patient. MHW regards such reagents as pharmaceuticals for registration purposes, requiring the same precautionary testing that, though necessary for drug products, are irrelevant for *in vitro* reagents. MHW has, however, shortened the approval time.

Many of the issues addressed by the proposals listed above would seem to apply equally to foreign and domestic firms in Japan. In practice, however, they are greater problems for foreign companies. Most domestic companies, for example, are not concerned with submission of foreign test data, license transfers, or transfers of manufacturing location between countries. Moreover, most domestic companies can get around the requirement for re-registration of modified products for all but the most major changes, whereas foreign firms are bound to the strict letter of the law by the fact that their products are constantly checked when passing through customs inspection. Finally, the lack of clearly defined and codified regulatory procedures in Japan is especially disadvantageous to foreign firms that lack prior experience in what MHW likely will or will not accept in its case-by-case judgments.

Nonetheless, TSG proposals for changes such as those regarding *in vitro* diagnostics, product modification and product classification are also supported by Japanese companies and industry groups. Both foreign and domestic companies, for example, are pursuing discussions with MHW about the *in vitro* diagnostics question through the Japan Reagents Association, established in 1983.

TSG believes that its proposals are of a kind that would help make MHW regulation more efficient. The Ministry itself has actively worked toward this goal in recent years, by such measures as installing a computer control system for product files, separating the approval process for cosmetics from that for medical devices, and working toward a harmonization of regulatory standards with medical regulatory agencies in other countries.

From the viewpoint of foreign companies in the medical supplies and equipment sector, successful implementation of MHW's recent decisions on regulatory changes will depend on the continuation of its positive attitude toward the modernization and streamlining of its regulatory activities. TSG plans to monitor MHW's efforts to put into practice the changes to which it has agreed in principle.

COSMETICS

Substantial progress in removing NTBs in the cosmetics

field has been made as a result of efforts begun in 1980. In addressing these problems, foreign manufacturers operating in Japan have worked in close coordination with the Japan Task Force of CTFA (Cosmetic, Toiletry and Fragrance Association) in the United States and with the Office of the U.S. Trade Representative.

Trade barrier issues that have been successfully resolved are summarized below.

- 1) MHW's list of ingredients approved in previously registered cosmetic formulations was not available to the public. The Ministry reversed this policy in 1982, when it released listings of more than 2400 ingredients approved or in use.
- 2) Safety testing to support product registration had to be conducted in Japan. Now, all U.S. animal test data are accepted.
- 3) Product registration procedures were complicated and involved needless delay. Some procedures have now been eliminated or simplified. Minor formula or pigment changes, for example, are now permitted without re-registration of the product, and MHW will now expedite the re-registration of a previously approved formulation that has undergone a change in name.
- 4) Use of as-yet unregistered products in consumer preference tests, formerly forbidden, is now permitted. Also, the quantity of unregistered-product samples that may be imported has been increased.
- 5) Registered products being imported are no longer subject to time-consuming MHW testing as they enter Japan.
- 6) Only Japanese legal entities could hold product registrations in the past. Now, U.S. firms may hold product registrations in their own name. Where it is held by a Japanese entity, the product registration may now be transferred to another such company if the foreign manufacturer remains the same.
- 7) Criteria for MHW evaluation of ingredients and of cosmetic product safety were unclear, and the standards-setting process was not generally open to U.S. firms. MHW has now established an advisory subcommittee with foreign participation.

A continuing source of frustration, however, is the long time required to complete the registration of a product. During the second and third quarters of 1983, registrations took about two-and-a-half to three months — a considerable improvement over the five to six months previously required. But during the fourth quarter of 1983 and the first quarter of 1984, they stretched out to five or six months again. Further improvements are being made in this critically important area.

Outlined below are recommendations which TSG believes would reduce MHW's registration workload significantly, without circumventing established standards for product approval.

- 1) Adopt a "notification only" approval system for formula-

tions in which the ingredients are on MHW's list of approved ingredients.

- 2) Adopt a "notification of revised formulation" approval for modifications of registered products where only a minor change of ingredient concentration is involved and the product identification remains unchanged, and for substitution of approved colors in shaded products such as lipstick and nail lacquer.
- 3) Allow a company that has changed its legal address to transfer all product registrations to the new address without delay or penalty, rather than requiring re-registration of all products as is presently the case.
- 4) Provide a mechanism for periodic updating of the published list of approved ingredients.
- 5) Make public the list of ingredients approved in previously registered quasi-drug products, including acceptable levels of concentration.
- 6) Establish criteria, now lacking, for MHW acceptance of safety test data, human test data, allergy test data and clinical or dermatological test data.

Finally, TSG regards the broadening of efficacy claims for cosmetic products as a major issue that MHW will have to face in future. The cosmetics industry is regulated under the Pharmaceutical Affairs Law (1960) and a related Enforcement Regulation (1961). Both law and regulation have been revised a number of times, but they do not reflect the progress made by the industry in science and technology in recent years. As a result, product differentiation is difficult, and particularly so for foreign companies that are only now attempting to enter the Japanese market.

AGRICULTURAL CHEMICALS

U.S. chemical companies have been concerned about a directive issued in 1978 by the Ministry of Agriculture, Forestry and Fisheries (MAFF) that all toxicology studies (safety testing) of these products be conducted in public laboratories in Japan. The sole exceptions were one acute and one chronic study, which could be conducted overseas, in either private or public laboratories.

It was pointed out to MAFF that the directive was potentially a major non-tariff barrier for foreign companies in this field. It meant expensive duplication of research already conducted abroad. It slowed the process of product development due in part to the insufficient number of public toxicology laboratories in Japan at that time. It disregarded the international tradition of reciprocity in accepting safety data generated in other countries. And it was discriminatory, in that data from in-house laboratories that represent substantial investment in personnel and facilities by private firms were thereby categorized as not generally acceptable.

In approaching this problem, U.S. companies in Japan worked closely with an *ad hoc* committee formed in the United States by the National Agricultural Chemicals Association (NACA). Since 1982, work has gone forward in concert with the Foreign Companies Group, which represents all foreign producers of agricultural chemicals that are active in Japan.

Japanese companies meanwhile have also called upon MAFF to take a less strict position. Companies that export to the United States found that their own data were accepted more readily by the U.S. government than by the Japanese government, and in many cases Japanese firms supported the foreign complaints when asked by MAFF to comment.

Substantial progress has been made. MAFF has decided in a spirit of cooperation not to implement its 1978 directive, on the grounds that it was widely viewed as a trade barrier. Meanwhile, the U.S. companies worked with NACA and with European Community groups to develop GLP (Good Laboratory Practice) standards for toxicology testing.

U.S. GLP standards, published in November 1983, have been provided to MAFF for its consideration in the drafting of its own GLP standards, now in progress. Meanwhile, MAFF is also drafting new guidelines for toxicological studies. It is believed that the final combination of guidelines and GLP standards will result in rules that will be acceptable to all parties.

FOREST PRODUCTS

The United States continues to enjoy a large surplus in forest products trade with Japan. In 1983, U.S. forest products (wood and paper) exports to Japan totaled \$2.1 billion, following levels of \$2.3 billion in 1982, \$2.0 billion in 1981 and \$2.8 billion in 1980. Much of this trade is in raw materials (logs and wood chips), but there has been a trend to more finished products and more paper-related products.

For example, Japan relies on imports for some 40% of the wood chips used by paper and paperboard manufacturers. Pulp imports from the United States, which are duty-free, rose from 470,000 metric tons in 1979 to 609,000 metric tons in 1983. Imports of higher added-value products are at lower levels but have been rising at a faster rate. Total U.S. paper/paperboard exports to Japan rose from 192,000 metric tons in 1979 to 499,000 metric tons in 1983, led by news print and kraft linerboard.

Due to its cost advantages, the U.S. wood and paper products industry has chosen to make very few investments in Japan. Instead, rather substantial investments have been made in Japan-oriented facilities in the United States and Canada.

Several recent events and trends have reduced barriers and, it is hoped, will promote U.S. exports of these products

to Japan:

- Revision of Japan Agricultural Standards (JAS) for softwood plywood
- Continuing dialogue between the U.S. and Japanese paper industries via the Japan Paper Association and the American Paper Institute
- Annual meetings among the U.S. government, the Japanese government and the forest products industries of both countries to exchange views
- More informed market promotion by U.S. associations, such as information distributed by the Western Wood Products Association about dimension lumber and Japanese-language material prepared by the National Forest Products Association and the National Lumber Exporters Association.

In addition to these developments, the U.S. forest product industry welcomes the decision not to establish a Wood Import Association in Japan. The U.S. industry believes this proposed association would have been a "soft cartel" which would have regulated and limited imports. The Ministry of Agriculture, Forestry and Fisheries, however, says the intended purpose of the association was only to promote exchange of information and that the decision not to form the association resulted from a lack of consensus among Japanese importers.

Among the factors that will influence the further opening of the Japanese market to U.S. forest products are the following.

- The paper and paperboard industries are among those undergoing restructuring under Japan's Law for Structural Improvement of Specific Industries. The extent, timing and effectiveness of capacity rationalization, however, are not yet clear. Japan's lumber and plywood industries have also been attempting to rationalize capacity.
- Although the tariffs on several paper products were reduced 2-3% in April 1983, the U.S. side believes the rates remain formidably high on several imported products — 9.3% for kraft linerboard, 12% for particleboard, and 15% for both softwood plywood and veneer. (Japan recently decided to reduce the linerboard tariff to 8.5% in April 1985, 7.7% in 1986 and 7% in 1987.)
- Log exports from federal forests in the West and from state forests in such states as Alaska, Oregon and California are prohibited. With the growth of West Coast log exports to China and South Korea since 1980, however, a tight market in the future would likely bring this politically sensitive issue to life again.
- Further recovery of Japanese housing construction from its present recession and a strengthening of the yen (vis-a-vis the dollar) will directly affect the volume of U.S. exports.

TSG believes that there should be more aggressive, more intelligent, and more sustained marketing by the U.S. industry in Japan. It should be noted that Japanese buyers

sometimes claim to be dissatisfied with U.S. forest products in terms of quality, service and stability of supply. Some Japanese buyers also complain that U.S. companies insist at times on their own methods of doing business when dealing with Japanese customers.

TOBACCO PRODUCTS

Encouraging progress has been made toward the eventual elimination of discriminatory barriers against imported tobacco products. The number of licensed retail outlets permitted to sell imported brands was increased from 20,000 to 70,000 in 1983, and the Japanese government has announced that all licensed tobacco retailers — some 260,000 — will be allowed to deal in imported brands as early as April 1985. Also in 1983, approved advertising allocations (the maximum advertising outlays allowed each company, allocated according to the previous fiscal year's sales volume) were increased by 150% and a number of lesser discriminatory practices were either eliminated or reduced. Most notably, 1983 brought a significant improvement in relations between foreign tobacco companies and the Japan Tobacco and Salt Public Corporation (JTS).

The Japanese tariff on cigarettes was reduced from 90% to 35% in 1981, and further to 20% in 1983. This is the same as the U.S. tariff for cigarettes. Almost simultaneously, a ¥1 per cigarette surcharge was then imposed on JTS and imported brands alike at retail level. The net effect of these changes was to reduce the retail price premium of leading foreign brands over JTS brands — a premium resulting from a JTS-mandated pricing formula and the "tax on tax" effect described below — from ¥110 per pack to a still unacceptable ¥80 per pack. This perpetuates the main problem confronting foreign companies that seek to compete on equal terms in Japan: the artificial retail price premium required on foreign brands.

Legislation enacted by the Japanese Diet in August 1984 will end the system under which JTS regulates the promotion and marketing of all brands sold — imports as well as its own. JTS will continue to monopolize the manufacture of tobacco products in Japan. Regulatory powers will pass from JTS to the Ministry of Finance.

This legislation has potential for liberalizing the import and wholesaling of tobacco products. But it leaves intact the uniform retail pricing system — including the artificial premium at which foreign brands must be sold.

The legislation makes minimal progress regarding the problem of tax assessment of foreign brands. Japan presently imposes a 56.5% *ad valorem* tax on all foreign-brand and first-class cigarettes — but for imported brands it is applied to CIF value (landed cost) *plus* the 20% import duty. By contrast, the United States imposes a specific tax on cigarettes: a unit (cents-per-cigarette) basis, rather than a percentage-of-

value basis. This approach to assessment, if adopted by Japan, would eliminate the "tax on tax" problem, reducing significantly the retail price handicap under which foreign brands must compete in the Japanese market.

Japanese members of TSG note that, in assessing domestic taxes, it is accepted international practice to consider landed cost plus tariff as equivalent to ex-factory price of goods. Also, Japanese firms encounter similar "tax on tax" problems in the American market, such as in assessment of state sales taxes.

FOOD PRODUCTS

Beginning in May 1982, the Japanese government has lowered tariff rates or raised import quota ceilings for a number of imported food products on four occasions as part of its successive packages of market-opening measures. The latest such package, announced in April 1984, also removed six categories of food products from import quota control altogether. (See Chapter 2).

Quota Controls

Around 20 tariff categories of food products continue to be controlled by import quotas, however. These categories include several hundred individual items. Regarding some of these items, such as beef and fresh oranges (quota increases for both of which have been specified for the fiscal 1984-87 period), the U.S. government appears to accept the Japanese position that immediate removal from quota control is not feasible.

Regarding some other items, TSG believes that early liberalization is feasible.

One of the categories to be freed from quota control during 1984, for example, is "fruit juices of prune, cherry, apricot and berries (other than blueberry and strawberry), and of tropical fruits (other than pineapple)". Production of these fruits and berries is not an important part of Japanese horticulture, and removal of their juices from quota control will not have a severe impact on Japanese farmers. Moreover, Japan's imports of passion fruit, guava and prune juices and purees are primarily from U.S. suppliers in Hawaii and California. Removal from quota control should make these products a much larger item of U.S. export to Japan.

Some other items under quota control are more important to Japanese agriculture. In the case of products such as processed cheese and tomato catsup, however, most major foreign brands are already being manufactured in Japan. This should slow the speed of import penetration if these products are liberalized, thus reducing to some extent the impact of liberalization on Japanese farmers.

TSG believes that the U.S. government should negotiate for the removal of Japanese quota control from im-

ports of other food products where removal would similarly benefit U.S. exports without serious harm to Japanese agriculture.

Another problem in some cases is determining exactly what is or is not under quota. Tariff No. 21.07 is said to contain several hundred items which have never been disclosed in the published list. Peanut butter, canned sweet corn and Korean ginseng teas are among the very few non-quota products listed in this tariff.

Quota Allocation System

Under current quota allocation practice, it is difficult for prospective foreign suppliers of quota items to identify the holders of licenses for importing these items. Available information as to the criteria for awarding licenses is also uncertain. As a result, a portion of the quantities allowed under a quota are not actually imported in some cases, due to the marketing difficulties which the allocation system presents to the final user in Japan.

Import quota allocations are announced by the Ministry of International Trade and Industry (MITI) in its daily publication *Tsusho Koho*, and the criteria for importers who may apply for these items seem to be clearly spelled out. But in practice, these criteria are not always followed.

Consider the case of MITI's "Miscellaneous Import Items" announcement, covering 23 items including fruit purees and pastes, which is published semiannually. The following rules are listed for those applying for quota allocations:

- Must have orders from final users (wholesalers or retailers) and must have
 - a) received a previous allocation and
 - b) imported the item sometime during the previous year
- Must submit these documents with application:
 - a) Original offer sheet from supplier
 - b) Signed order sheet from final user
 - c) Explanation of item to be imported, signed by final user
 - d) Proof of previous import

In practice, only the previous-import record must be authentic. Most of the other documents are only for show. For example, the importer must know how large his allocation will be before he can approach buyers in Japan. For filing with MITI, therefore, the importer often presents a meaningless "offer sheet" — obtainable from a supplier's agent that will issue such a sheet to anyone, without commitment as to contents. The importer then obtains an "order sheet" from a friend who has no obligation to buy later. MITI does not generally check the authenticity of these documents.

Because of Japan's complex and non-transparent system of import quota allocation, it is sometimes the case that the full quantities allowed under the quota are not actually imported. Final users of fruit puree or paste, for example, do not know who may be holding allocations or the size of the allocations. This makes it difficult to develop a new product based upon imported puree or paste, since production and marketing plans must be made months in advance of product introduction, with assurance that the needed quantities of imported materials will be available.

Chapter 4

PROBLEMS IN SERVICE INDUSTRIES

INTRODUCTION

Service businesses are Japan's fastest-growing industrial sector. They are also businesses in which U.S. companies, based in the world's most service-oriented economy, often claim the lead in innovation and competitiveness. Yet trade problems as varied as the industries that comprise this sector continue to trouble service trade relations between the United States and Japan.

This chapter deals with bilateral trade problems related to six service industries: insurance, banking, legal services, maritime transport, telecommunications and publishing, with a summary of recent progress in eliminating or reducing the problems in each industry.

INSURANCE

U.S. insurance companies — both life and non-life — enjoy in general the same freedom of operation and protection under the law as do Japanese insurance companies. Restrictions or modifications to their licenses, as compared to the regulations governing Japanese insurance companies, are either in accord with the U.S. companies' business plans or are incidental, because of branch-office characteristics, to the essential conduct of business.

The regulation of the insurance business in Japan will be surveyed first, followed by an analysis of the situation of U.S. insurers in the Japanese market.

1) Regulation of the Insurance Business in Japan

The Japanese insurance business is regulated by the Ministry of Finance (MOF) because of the great influence of that business on the national economy and its close relationship with social and public interests. The Insurance Business Law and the Law Concerning Foreign Insurers, which MOF administers, require the licensing of insurers.

Regulation takes three forms: guiding and supervising insurance business operations; maintaining and promoting a sound insurance market; and protecting the interests of policy-holders. It may be said that foreign insurance companies are in some respects treated more favorably than domestic companies under Japanese regulation.

It is MOF practice to license foreign insurance companies unless there is a problem of consumer protection.

MOF has to date licensed 18 foreign life insurance companies (including three Japanese firms having foreign capital affiliation) and 39 non-life insurance companies (including one Japanese firm having foreign capital affiliation). No new Japanese life insurance company has been licensed in the past 40 years, and no Japanese non-life insurance company since 1951 other than one earthquake reinsurance firm.

When entering the Japanese market, a foreign insurance company has the choice of establishing a branch office or a subsidiary. Once licensed, it can operate freely throughout the country. (By contrast, an insurance company operating in the United States must obtain a license from each state in which it wishes to do business.) The number of sales offices may be increased without restriction.

Foreign companies have been given preferential treatment regarding the introduction of types of insurance coverage new to the Japanese market. American Family Life Assurance Company of Columbus was given approval in 1974 for exclusive sale of cancer insurance, for example, and American Life Insurance Co. received like approval for an innovative form of health insurance in 1975.

2) Situation of U.S. Insurers in the Japanese Market

The goal of U.S. insurance companies licensed to do business in Japan is to increase profitable production, for the benefit of the companies and the Japanese insurance industry, while maintaining the highest standards for the protection of consumers' rights. The means to reach this goal are the basic principles of business management: to provide high-quality, innovative products on a competitive basis in accordance with consumers' needs.

It is regarding the means that U.S. companies operating in Japan are often frustrated. In the circumstances most familiar to U.S. insurers, *coverage* and *cost* are the competitive factors considered by consumers when they purchase insurance. Accordingly, insurers structure an internal balance of underwriting, actuarial and marketing disciplines from which result products that are competitive on a coverage and cost basis. The success or failure of an insurance program — the increase or decrease of market share — is determined by the quality of the product and the consumer's acceptance of the coverage and cost factors. Standardization of contracts and rates under a tariff system effectively reduces the capability of foreign insurers to compete in Japan. U.S. insurers,

lacking the traditional business and cultural relationships of Japanese companies yet operating within the general tariff system of the Japanese insurance business, are at a disadvantage.

It should be noted that both the Japanese tariff system and the "open" system used in the United States are designed for the ultimate benefit of the consumer. The Japanese system guarantees a relatively standard product that protects both the insured and the insurer. The stability of the market enhances management and control, and consumers enjoy the protection of this supervision. This stability can be seen in the fact that no licensed Japanese insurer has gone bankrupt since the end of World War II. On the other hand, in the U.S. system the dynamics of more open competition in coverage and cost results in a flexibility of product design and pricing that responds closely to the varying needs of consumers.

Neither Japanese nor U.S. insurers insist upon the ultimate application of either system. It is commonly agreed that a rigidly inflexible tariff would be as counter-productive as would a completely unregulated market. What is in dispute is the perception of how much change is taking place in the Japanese market.

Any change within a highly structured system is seen by those within the system as being significant. The same change viewed from outside the system may appear to be less significant. A formula permitting discounts from standard rate levels in certain circumstances, or permitting a variety of licensed foreign insurers to operate within Japan, are indeed remarkable variations in a structured system. They may be relatively insignificant as perceived by those outside the Japanese system — particularly if the variations merely maintain standardization with uniform options. This difference of perception applies to the timing of changes as well. Changes that are reviewed and effected in two years can be considered dramatic departures from customary procedures if the period of time for such changes in a structured system is normally four years. Perceived from outside, where similar changes may be effected in a matter of months, or even immediately, the rate of change seems rather slow.

In conclusion, the Japanese and U.S. insurance companies operating in Japan have precisely the same goal: to maintain the financial health of the industry and to provide customers with quality products. U.S. insurers believe this can best be accomplished if the system in Japan evolves to the point where *coverage* and *cost* become the determinants in the decision to purchase insurance.

BANKING

The Japanese financial system has undergone rapid structural change since the 1970s and especially in the last two years. The new Banking Law of April 1982 revised the

general banking practice of the previous fifty years with the objective of encouraging fair competition among all banks. In April 1983, the Committee on Financial System Research of the Ministry of Finance (MOF) prepared an interim report regarding efforts to deregulate the Japanese financial system. Throughout this process of change, Japanese banking has been regulated in reference to three principal considerations: maintenance of credit and other standards; protection of depositors; and efficient operation of the financial system. The process of rapid structural change is continuing, with some benefit to foreign banks operating in Japan.

A May 1984 report by the U.S.-Japan working group on yen-dollar exchange rate issues to Minister of Finance Takeshita and Secretary of the Treasury Regan contained a number of liberalization measures which should benefit foreign banks. Some of these measures are already being put into effect, while others are under study. Foreign banks in Japan are hopeful that such study will not hinder timely implementation.

Recent measures that represent progress in liberalizing Japan's financial markets are summarized below.

1) Elimination of real demand for forward foreign exchange transactions

The rule that had required forward foreign exchange transactions to be based on actual demand arising from business transactions such as exports and imports was eliminated on April 1, 1984. This change allows corporations to take positions based on their assessment of foreign exchange rate trends. The result has been a greater volume of foreign exchange transactions in which the foreign banks have a higher proportionate share than their share of total banking assets.

2) Funding of domestic currency through currency swaps

All limits related to the conversion of foreign currency into yen for purposes of domestic currency funding were abolished on June 1, 1984.

3) Yen-denominated bankers' acceptances

MOF has indicated that it will establish policies, procedures, limits and other guidelines for the creation of a yen-denominated bankers' acceptance market in Japan by the end of 1984. MOF expects that a domestic yen BA market will begin to operate shortly thereafter.

4) Euroyen bond market

Foreign local governments, government agencies and non-Japanese corporations will be authorized to issue unsecured yen bonds in the Euromarket from December 1, 1984.

They will join foreign governments and multilateral organizations such as the World Bank on the list of entities previously authorized to issue Euroyen bonds. Qualification standards will initially be the same as those currently applicable to issuers in the domestic market, with some relaxation of these standards from April 1, 1985. In addition, about 30 Japanese companies are allowed to issue Euroyen bonds and about 100 Japanese companies (including the authorized bond issuers) are allowed to issue Euroyen convertible bonds. Domestic issuers will remain subject to Japanese withholding tax. Such securities may not be sold to Japanese residents for 180 days from date of issue.

Foreign investment banking firms will be able to lead/co-lead manage Euroyen issues for Japanese residents or non-resident issuers from December 1, 1984. MOF has confirmed that there are no restrictions on foreign investment banking firms in lead managing or co-lead managing issues of Japanese resident corporations or other issuers in currencies other than yen.

5) Currency swaps

MOF has confirmed that both Japanese resident and non-resident corporations can swap non-yen issues into yen without limitation. U.S. banks and investment banks are very active in this swap business.

6) Trust banking

Qualified foreign banks will be licensed to participate in the same range of trust banking activities as are currently performed by Japanese trust banks. Partnership with Japanese parties not currently authorized to participate in trust activities (commercial banks and securities companies, for example) will not be authorized. Such participation could include partnership with Japanese trust banks, but would exclude partnership with non-licensed firms. This would not exclude the establishment of service and advisory relationships for the conduct of trust banking business. The precise form of such participation and the criteria for selecting qualified banks will be part of a concrete plan to be announced by the end of 1984.

It is generally expected that foreign banks will be able to enter the trust banking business directly in 1985.

7) Negotiable certificates of deposit

Progress has been made in seeking reduction of the minimum value of yen certificates of deposit from ¥300 million to ¥100 million by April 1985, and the reduction of the minimum maturity period from three months to one month by the same date. In addition, MOF has indicated its willingness to authorize offices of foreign and Japanese banks

outside Japan to issue negotiable Euroyen certificates of deposit for maturities of six months. Implementation of the latter measure is expected by the end of 1984.

8) Liberalization of other deposit interest rates

MOF has indicated that it will permit banks, both Japanese and foreign, to sell large-denomination deposit instruments with market-determined interest rates by April 1985. Further relaxation and eventual removal of interest-rate ceilings on large-denomination deposits within the next few years is expected.

9) Overseas yen lending

MOF has abolished non-prudential restrictions on overseas yen lending by both Japanese and foreign banks. Foreign banks may also lead manage yen loan syndications. The first co-lead management in Japan by two U.S. banks was recently announced.

10) Underwriting and trading of government securities

Foreign banks may apply to the syndicate of yen government securities underwriters to participate in new issues of government securities. Three U.S. banks have so far applied to join the underwriting group and have been accepted. Other foreign banks can apply if they choose and would receive due consideration from the underwriting syndicate. The same is true for U.S. securities companies seeking to join the securities companies underwriting syndicate.

There remain a number of areas of banking, as broadly defined, where further progress would be welcome. A summary of these areas is offered here in a spirit of constructive criticism, for the benefit of all banks operating in Japan as well as all those who benefit from the products and services offered by banks.

1) Data transmission

Transfer of data by electronic means is permitted between a bank and its customer. Initiation of a transaction between a bank and its customer by this means, however, is not permitted with the exception of "pay by phone".

2) Domestic money market interest rates

Japanese banks generally price short-term yen loans in relation to the short-term prime rate, which is determined in reference to the Bank of Japan (BOJ) discount rate. BOJ makes funding available to Japanese city banks at the official discount rate under limited credit lines. These central

bank loans are extended on a fully secured basis or by rediscount of eligible discounted notes. Japanese city banks normally prefer direct loans to discount since they have an ample supply of government bonds to serve as collateral and the loan process is easier than discounting.

In Japan, central bank loans are understood to be a method used by BOJ to control the money supply and to provide short-term funding for contingency purposes. Central bank loans therefore do not provide a stable source of funds for banks.

Although foreign banks are permitted access to the BOJ rediscount window, they do not use rediscounting to fund their banking assets for the reason mentioned above. The other form of central bank funding, loans secured by Japanese government securities, is not a real alternative for foreign banks. Only three U.S. banks currently participate in the underwriting, sale and trading of Japanese government bonds. The very small amount allocated to these three foreign banks gives them only a small supply of government bonds to use as security for central bank loans.

It should be noted that borrowing by Japanese banks is associated with the possible imposition of certain controls by BOJ. Thus the advantages enjoyed by Japanese banks in funding from BOJ are accompanied by some drawbacks. This fact and the continuing absence of sufficient data to the contrary make it difficult to conclude that BOJ funding practice discriminates against foreign banks.

Foreign banks have traditionally priced their short-term loans in relation to the bills discount rates quoted for maturities of one, two and three months. (Although a maturity of four months is quoted, the lack of depth at this maturity makes reference to the four-month BD rate impractical.) Foreign banks are of the opinion that these rates are not determined by market demand nor do they reflect the amount (or lack) of liquidity in the market. As a result, the bills discount rate has become steadily less relevant as a means of determining the base cost of short-term yen lending for foreign banks. Japanese city banks, however, perceive that any differences between quoted bills discount rates and money market rates are only temporary. The city banks, therefore, are of the opinion that the bills discount rates do reflect money market rates. Thus, the bills discount rates quoted by the money dealers continue to be a valid basis of alternative pricing for the Japanese city banks — but not for the foreign banks.

3) Foreign exchange trading limits

All banks are restricted in the amount of overnight exposure (overbought or oversold) in foreign or non-yen currencies they can hold. The amount varies from bank to bank. This restriction might have been relevant when real demand was required to underlie foreign exchange transactions,

but since the elimination of that requirement many banks feel their respective limits are too restrictive. The limits should either be increased by a large amount or be eliminated altogether.

4) Transfer tax on certain securities

There is a securities trade tax ranging from 0.01% to 0.55% on transfer proceeds arising from the trading of yen securities. This tax effectively discourages rapid turnover through trading of yen securities, since the tax can be higher than the amount of overnight interest gained. Thus holders of these securities feel they have to keep them long enough so that the interest or trading gain at least compensates for the tax paid. The tax should be reduced so as to eliminate this trading disincentive.

5) Euroyen bond market

While the recent liberalization measures concerning Euroyen bonds and convertible bonds are welcome, consideration should be given to further relaxation of the standards so as to broaden the market.

6) Administration and reporting

All banks in Japan must submit a considerable number of reports to BOJ, MOF and other authorities. Many are clearly useful to the authorities, but some at least are of questionable relevance. The U.S. banks, individually and through the American Chamber of Commerce in Japan, are seeking to bring some of these reports to the attention of the appropriate authorities with the proposal that they be eliminated, modified or combined with other reports. This effort is being made in a spirit of positive contribution to Japan's financial system that will benefit all participants.

7) Purchase of Japanese banks

The Banking Law as revised April 1, 1982 permits a foreign bank to purchase a Japanese bank or other financial institution other than a securities company. An established procedure exists for submitting an application for such a purchase to the Japanese government. To date, TSG is not aware of any applications by foreign banks to purchase Japanese banks or other financial institutions. This seems to be due to the perception that owners of Japanese banks are reluctant to sell a controlling interest to another institution, whether Japanese or foreign.

In looking at the banking industry in Japan and the process of structural change now in process, it should be understood that there are some fundamental differences

between the financial systems of the United States and Japan.

The first difference lies in the determination of interest rates for deposits. In Japan, ceilings on deposit rates are determined by the government. Although rates for CD's or foreign currency deposits are freely determined and have recently increased substantially, most deposit rates are not sensitive to market forces.

The second difference is the concern shown by Japanese authorities about the possible impact on the weaker financial institutions of increased competition resulting from liberalization. It should be noted that the large Japanese banks are the source of most of the intensity in competition. Foreign banks and financial institutions are a very small part of the Japanese market.

In examining and understanding such differences between the financial systems in Japan and the United States, it should be fully understood that these differences are the product of historical developments in the two countries, and that positive steps are being taken in Japan to permit the increasing influence of market forces.

TSG strongly encourages further liberalization to permit all banks, Japanese and foreign alike, to participate as fully as possible in Japan's financial system.

LEGAL SERVICES

From the time of the establishment of the modern legal profession in Japan in the early 1870s until 1955, foreign lawyers were free to establish offices in Japan to practice law within the scope of their professional competence. However, in 1955, in what was apparently a reaction to the end of the Occupation, this freedom was for the first time taken away by an amendment to the Bengoshi (Practicing Lawyers) Law. Since then, Japan has been effectively closed to American and other foreign lawyers in private practice, except for a small number already licensed in 1955 and a few additional lawyers authorized to continue in practice at the time of the reversion of Okinawa to Japanese administration in 1972.

The demand for legal services appears to be about the same in Japan as in the United States. This can be seen, for example, by comparing the number of law majors graduating from college in Japan (about 30,000 per year, according to an estimate published by Keiei Hoyu Kai in 1983) with that of students graduating from law schools in the United States (36,387 in 1983, according to statistics compiled by the Association of American Law Schools). Against this comparison, it may be argued that not all those who study law in Japan pursue legal careers; but the same point can be made about those who study law in the United States.

The key difference is that in the United States most law school graduates who wish to become lawyers are able to do so, whereas in Japan those wishing to become *bengoshi*,

judges or prosecutors must first gain admission to a training school operated by the Supreme Court and complete a two-year course there. Since the training school has only about 500 openings per year, competition for entrance is intense. In 1983, for example, only 448 of the 25,138 applicants (1.78%) passed the entrance examination. Many of those who fail to gain entrance to the Supreme Court's training school proceed to alternative legal careers, becoming law professors, government in-house legal advisors, corporate in-house legal advisors, judicial scriveners, administrative scriveners, patent attorneys or tax attorneys. When these other legal occupations are included, the total number of persons providing legal services in Japan becomes more than 95,000 according to an estimate published by the Practising Law Institute in 1983. This is, per capita, comparable to the number providing legal services in other industrialized countries. There is a popular notion that the demand for legal services is less in Japan because of the harmonious structure of Japanese society, but it is not borne out by these statistics.

In a statement released in September 1983, Keidanren (the Japan Federation of Economic Organizations) expressed its support for allowing foreign lawyers to open offices and practice law in Japan. The American Chamber of Commerce in Japan likewise has expressed its support through statements adopted in July 1983 and June 1984. In the light of these statements by the leading spokesmen for the Japanese business community and for the American business community in Japan, there can be no doubt that the users of legal services in Japan perceive a real need for the services of foreign lawyers. U.S. companies in Japan can obtain these services from in-house counsel, but the high cost makes that option available only to the largest corporations.

A growing number of other industrialized countries have responded to such user needs by permitting foreign lawyers to practice on at least a limited basis without reexamination locally. In England and Belgium, foreign lawyers need no particular license to engage in the business of giving legal advice. In France and West Germany, foreign lawyers may easily obtain licenses as *conseils juridiques* or *Rechtsbeistände*, respectively. Since June 1984, foreign lawyers have been permitted to establish offices in New South Wales, Australia. As for the United States, there are special rules regarding the licensing of foreign lawyers in Massachusetts, New York and Tennessee, but the normal method whereby foreign lawyers obtain the right to practice in the United States is simply to take a state bar examination. Since the passing rate for the average state bar examination is about 66%, this is by no means an insuperable barrier to entry, and in fact between 50 and 100 Japanese nationals have passed these examinations and qualified as American lawyers within the past decade. This contrasts sharply with the 1.78% passing rate for the Japanese equivalent of a bar examination. Even the Ministry of Justice concedes that it would be virtually impossible for a person not

raised and educated in Japan to pass that examination and qualify as a *bengoshi*.

TSG joins Keidanren and the American Chamber of Commerce in Japan in calling for a return to the traditional freedom of foreign lawyers to establish offices in Japan to practice law within the scope of their professional competence. In particular, foreign lawyers should be permitted to establish offices in partnership with or employing Japanese *bengoshi* and, through such offices, to offer to any client comprehensive legal services covering both the Japanese and the foreign legal aspects of any problem. Furthermore, foreign lawyers should be permitted to use their own names, or the names of their firms abroad, in the names of the offices they establish in Japan.

TSG also takes note of the more than 100 trainees, most of whom are American, now in Japan. "Trainees" is the generic term for foreign lawyers who come to Japan to perform paraprofessional services under contract to Japanese law firms. These young lawyers are a human resource that should be developed, inasmuch as they embody much of America's present understanding of Japanese law. Therefore, TSG recommends that any new rules adopted to govern foreign lawyers should be designed to give present and future trainees the opportunity to make the transition from paraprofessional to professional status.

MARITIME TRANSPORT

In recent months, two longstanding trade barriers that posed difficulties to U.S.-flag maritime carriers have been removed: restrictions on repositioning of empty marine containers between ports in Japan, and the obligation to measure automobiles for export.

In the past, some U.S.-flag carriers received one-year clearance for container cabotage (repositioning of their empty containers from one Japanese port to another for efficient response to traffic demand), but other shippers were denied such clearance. These carriers had to file for customs approval a month in advance of container repositioning, and approval was given on a container-by-container basis. U.S. carriers report that the container cabotage problem has now been resolved.

It was also past Japanese practice to require measurement of automobile shipments from Japan prior to export. This involved physical checking of the outside dimensions of one vehicle of each type loaded aboard ship. Pure car carriers — vessels that transport motor vehicles only — were exempt. All such vessels are Japanese. The measurement requirement has now been dropped.

U.S.-flag carriers are still confronted with three major difficulties in serving Japan:

1) Prohibition of High-Cube Containers

The standard-size marine container is 40 ft long by 8 ft wide by 8½ ft high. The high-cube container is 1 ft (30 cm) higher. Use of these higher containers is permitted by statute or permit in all major trading nations of the world except Japan. (In Asia today, only Japan and Bangladesh prohibit their use.) Yet, ironically, Japan is a world leader in the manufacture of high-cube containers, which move regularly over the roads from factories in Atsugi and Toyohashi to Japanese ports for export.

The crux of the problem is the 3.8-meter legal restriction on height for movement on the roads. Police authorities insist that this restriction must be maintained for road safety. However, during a five-year moratorium when heights were allowed to exceed 3.8 meters, not a single accident was attributed to that factor. As for the contradictory policy of allowing newly manufactured high-cube containers to move over Japanese roads, it is explained that the matter is different since they are not carrying cargo. It should be noted that loading a container with cargo does not increase its height.

Ambassador Nobuhiko Ushiba, chairman of the Advisory Council of Japan's Office of Trade Ombudsman, recently turned down an appeal by U.S. carriers regarding this problem, despite the recommendation of the Ministry of Foreign Affairs that the carriers and the U.S. Embassy use the OTO approach to resolve the matter. At the urging of U.S. Ambassador Mansfield, however, Ambassador Ushiba did call a second meeting in July 1984. It was inconclusive but encouraging. TSG hopes that further meetings will be held.

2) Prohibition of Entry into Related Domestic Transport Services

U.S.-flag carriers would like to have the right to enter trucking, stevedoring and warehousing businesses in Japan — as Japanese companies can and do enter these businesses in the United States. The laws that severely restricted foreign ownership of stevedoring and trucking firms were amended in 1979 to remove such restriction. (Foreign equity in warehousing firms was not restricted by law.) The Ministry of Transport, however, continues to favor those companies — all of which are Japanese-owned — already in these three businesses, to the exclusion of new applicants. To the best of our knowledge, it is impossible to obtain licenses to enter any of these important ancillary businesses. This represents a denial of opportunity for investment, of the option to offer a more varied package of services, and of a means of controlling costs.

3) Carriage of Leaf Tobacco from the United States to Japan

Japan imports leaf tobaccos in part by the Japan Tobacco & Salt Public Corp. (JTS), but mostly by Japanese trading companies designated by JTS. Carriers of foreign leaf tobacco are selected by JTS and by the trading companies for their respective imports. However, the trading companies can only select carriers approved by JTS. To date, only Japanese carriers have been approved.

Until 1982 Japan imported U.S.-grown flue-cured and Burley leaf tobaccos in hogsheads. The service of U.S.-flag bulk-cargo vessels was not then available. Accordingly, only Japanese bulk-cargo vessels were used, except for a few trial shipments (1977-1981) of cardboard case-packed leaf tobacco by Japanese all-water container vessels. After these trial shipments, JTS decided to transport U.S.-grown leaf tobaccos on a regular basis by all-water container vessels.

Despite active efforts by U.S.-flag carriers to obtain a share of this business, JTS refused to approve any U.S. carrier. Only after considerable attention was focused on this issue in private groups such as the U.S.-Japan Businessmen's Conference as well as in official groups did JTS agree to use U.S. carriers on a trial basis. The result was a JTS decision to conduct trials for three years by two U.S. lines to transport four containers of JTS imports each, for each type of leaf tobacco.

JTS has stated that when a new transportation method is introduced, its rule is to conduct trials for some years to confirm the safety and economy of the method. The transport of U.S. leaf tobacco by the two U.S. lines is by the mini land-bridge (MLB) method, which JTS is trying for the first time. Therefore, in keeping with its practice for other trials in the past, JTS decided to conduct three-year trials of the MLB method by U.S. carriers.

In the U.S. carriers' opinion, however, these trials are hardly more than a pretext for continuing to allow Japanese carriers to monopolize this \$20 million-a-year business. The U.S. carriers point out that they have had many years' experience carrying tobacco to other countries and many years' experience carrying virtually every other commodity for the Japanese trading companies in question.

In response, JTS says that there have been two accidents during the trials so far — one involving pilferage during the overland portion of the carriage and one involving water damage while at sea. Because of these accidents, JTS remains concerned about the safety of the MLB method. The U.S. carriers, while not defending these accidents, do not believe that they are a statistically valid basis for drawing conclusions about the safety of the MLB method or of U.S. carriers in general.

TSG, though unable to judge the merits of this dispute, does consider it unfortunate that so much pressure had to be brought to bear on JTS before it would consider the use of U.S. carriers. Given the present level of trade friction, TSG hopes that JTS, government-owned corporations and government agencies will make an active effort to be sensitive to foreign concerns so that problems such as that of tobacco carriage can be solved before they reach the level of bilateral conflict.

TELECOMMUNICATIONS SERVICES

Two proposed laws before the Diet at mid-1984 would convert Japan's telecommunications services business from a regulated monopoly to a free and competitive market. The proposed Telecommunications Business Law would set new rules for the telecommunications services business that accommodate recent advances in technology and changing social needs. It also provides for access to these markets by foreign firms. The proposed Law on Nippon Telegraph and Telephone Ltd. defines rules to be applied to Nippon Telegraph and Telephone Public Corp. when that government-owned monopoly is reorganized as a joint-stock company.

Even though political consensus has almost been reached on the provisions, the draft legislation for both laws leave certain important areas unspecified. They are left for further definition in a Cabinet order or in ministerial ordinances of the Ministry of Posts and Telecommunications (MPT) — or perhaps they have been overlooked.

The current bill for the Telecommunications Business Law calls for division of enhanced or value-added network (VAN) services into two categories, each subject to a different degree of government oversight. The bill stipulates that a Cabinet order should define the categories. It differentiates degrees of government oversight of business entry into these services by category. The wording does not clearly define the differences or the extent of government control, however.

TSG believes that the definition of the categories and degrees of government controls should be such as to assure maximum benefits to users, to promote fair competition and to ensure national treatment of foreign-owned companies. Transparency of the rules is an important factor in realizing these goals.

The bill for the Law on Nippon Telegraph and Telephone Ltd. lacks transparent provisions that require separate accounting for basic and enhanced service businesses of the government-affiliated corporation. It is said that, as the interested parties have agreed, the accounting separation should be stipulated in the MPT ministerial ordinance related to the Telecommunications Business Law, to which all suppliers of services, including the reorganized NTT, should adhere.

TSG believes it is essential for sound development of enhanced telecommunications services in Japan that the MPT ordinance provide clearly worded, practical stipulations for accounting separation for basic and enhanced services. Reasonableness and transparency of these stipulations are important elements in ensuring that those who enter the enhanced services business can compete on a fair basis with NTT. It is TSG's position that imaginative entrepreneurs, operating in a climate of free competition and minimal government regulation, can best serve their customers and the public at large.

Domestic Data Communications

Japan's restrictive regulation of domestic data communications was relaxed by revisions in the Public Telecommunications Law that went into effect in October 1982.

For example, permission was selectively granted in the past for business-related parties to lease a dedicated line (a line used only for data communication) jointly, with prior approval. The revised law places no restriction on joint leasing by parties having an on-going business relationship. The revised law also allows, in principle, connection via public line to a dedicated leased line, whereas case-by-case approval was necessary in the past. Public line/leased line/public line connections, completely prohibited in the past, were also opened subject to MPT's case-by-case approval.

International Data Communications

Customers in Japan have access to data-processing and data-base services in other countries via public network or lines leased from Kokusai Denshin Denwa Kaisha (KDD) by firms offering these services. Message-switching to an overseas computer — 'electronic mailbox' service whereby messages rather than data are transmitted to the computer for subsequent retrieval by the addressee — is not allowed by Japanese law. However, message-switching within Japan is permitted in some cases. These rules are in accord with the recommendations of the International Telegraph and Telephone Consultative Committee.

There are almost no restrictions barring computer-line links between a company in Japan and its affiliates overseas or between unaffiliated companies that have a 'strong relationship' (contractual or other). Such a link with an overseas party having no contractual or other on-going business relationship with the company in Japan, however, is not allowed. There are no restrictions on international data transmission using acoustic couplers.

PUBLISHING

Publishing in Japan is a ¥2 trillion (\$8.7 billion) business involving some 3000 companies, most of them rather small. It employs some practices unique to the industry and some that are found also in other Japanese businesses. These practices apply to both Japanese and foreign publishers, though they may appear to have a more adverse effect on foreign publishers who are not familiar with them.

1) Distribution System and Sales Practice

The general line of distribution for publications in Japan is from publishing company to wholesalers (agents) to retail booksellers. The most striking feature of distribution is that two major wholesalers, Tokyo Shuppan Hanbai Ltd. and Nippon Shuppan Hanbai Ltd., together account for 70% of all wholesale sales to retail outlets nationwide. Unless one of these two wholesalers handles a publication, its distribution is limited.

There is no direct evidence, however, that this domination of wholesaling presents a major difficulty in distribution of foreign publications. Most imported items are handled by two other firms: Western Publications Distribution Agency (better known as Yano), a specialist in books and magazines which services the major bookstores having foreign-language departments and the bookstalls of major hotels throughout Japan; and Overseas Courier Service Co., Ltd., which is the subscription agent for most leading foreign-language newspapers and magazines.

Direct sales are possible to schools and to Kiosk, which operates newsstands at Japan's railroad and subway stations and at airports.

In publishing, as in many other Japanese businesses, there is emphasis on "an orderly market". One means of ensuring that all concerned share in the profits is distributors' use of a resale price maintenance system. Publishing companies may choose to participate in the system or not — but non-participation almost guarantees exclusion from the distribution system. Participation does protect publishing companies by ensuring their receipt of a designated percentage of the retail (cover) price of their publications nationwide.

Among retail bookstores, consignment sales is the practice. Publishers are paid only if their publications are sold. The straight-purchase system exists but has not spread, due to the great risk it poses for the retail bookstore, typically a small, family-operated shop.

The major differences between Japan and the United States in the distribution of publications are summarized below.

	Japan	United States
Resale price maintenance	Practiced	Not practiced
Cost of distribution	Fixed margin of about 30% since discounting not possible	Discounting is widespread
Royalty advances	Not practiced	Practiced
Third-class postage rules	Advertising space cannot exceed editorial space	

2) Publications Trade

The gap between imports and exports of publications has narrowed in recent years due to the rise in Japanese exports. It should be noted that exports include foreign publications bound in Japan as well as publications intended for Japanese residents and those of Japanese descent residing abroad. Meanwhile, translation of foreign works into Japanese is growing. Today, new works by well-known American authors are often translated and put on sale in Japan at the same time that the original publication appears in the United States.

3) Trade Problems

TSG knows of no discrimination against foreign publishers either in Japanese law or in government administration. The publishing industry itself, like other business sectors that consist mainly of small firms, takes a cautious view of the entry of foreign contenders.

The two major distribution agents mentioned above wield great authority through their dominance of nationwide distribution at the wholesale level. They can be expected to resist strongly any initiative that might alter or disrupt the present distribution system, such as the expansion of direct sales by publishers to booksellers. Neither publishers nor booksellers are in a position to resist such pressure.

At one time, for example, foreign-owned companies

organized book clubs and tried to deal directly with publishing companies and bookstores. These attempts failed, due to resistance mounted by established distributors.

However, foreign-owned companies have expanded sales in Japan by introducing unique marketing techniques and exploiting new areas of publishing. An example is the product differentiation practiced by magazines such as *Time* and *Newsweek*, which have established the image of "must" reading among Japanese intellectuals. Sales differentiation has also proved successful. McGraw-Hill, for example, circumvents the bookstores by selling to "members", who are persons specifically interested in its publications.

Postal regulations for third-class postage, which provides economical rates for publications, have been the target of complaints from some foreign publishers. This seems to be more a matter of misunderstanding than a real problem. These regulations are basically the same as second-class postage regulations in the United States and cannot be considered a major difficulty.

Working visas for foreign staff, however, do present a problem. Although the restriction is not limited to publishing services, editors and those similarly employed are normally permitted a renewable one-year working visa. In practice, visas are usually issued for a shorter period. The newcomer is normally issued a three-month visa, and after two or three renewals the period is extended to six months. Only after two or three years in Japan is the employee usually given a one-year visa. This is obviously an unsatisfactory situation for both the editorial employees and the companies that employ them.

Finally, it should be noted that the Japanese magazine market is now following a trend seen earlier in the United States: the appearance of large numbers of specialty magazines, followed by the demise of some of the older, general-interest magazines. U.S. publishers are finding new markets in Japan through cooperation with Japanese publishers in launching magazines in fields such as sports, science and technology.

Chapter 5

HIGH TECHNOLOGY

High technology encompasses numerous disciplines and technologies and spans a wide range of products and services. This chapter does not attempt to survey all of them. Rather, it presents five brief case studies — ranging from the relatively old fields of computers and semiconductors to the relatively new fields discussed under the heading of telecommunications and information technologies — to illustrate the problems that U.S. companies have faced in attempting to participate in Japan's high-technology market.

TSG emphasizes that in the first two industries discussed, computers and semiconductors, the problems of the past appear to have been satisfactorily resolved. References below to past problems in those two industries should be understood not as an attempt to resume old disputes, but rather as an effort to place present problems in correct historical perspective.

In all five of the industries discussed, Japanese and American companies are locked in competition in research and development, marketing, and sales. Except for the communications satellite industry, this competitive struggle spans the globe, but in these same industries, Japan and the United States are important to each other as customers, suppliers, and generators of new technologies and applications. The intertwining nature of these two high-technology markets and the industrial bases underlying them should be borne in mind as the reader examines the following brief case studies.

Computers

Japanese government interest in the computer industry began in the mid-1950s with the formation of a study group that included officials of MITI (the Ministry of International Trade and Industry), university scientists, and representatives of prospective manufacturers. This group reached a consensus that government measures were necessary if Japanese-owned computer companies were to be able to develop, given the virtual domination of the world computer market at the time by IBM.

The policy followed by the Japanese government from that time into the 1970s was fivefold:

- To restrict imports of computers
- To prohibit the establishment of wholly foreign-owned computer manufacturing companies in Japan
- As for IBM, which already had a wholly-owned Japanese manufacturing subsidiary (IBM Japan, established in 1937), to condition its ability to manufacture computers in Japan and to repatriate dividends upon its agreement to license its patents to Japanese-owned computer companies and to self-restrain its market share*
- To give preference to the products of Japanese-owned computer companies in procurement by the Japanese government and government-owned enterprises
- To nurture Japanese-owned computer companies through a variety of subsidies and tax benefits

This fivefold policy was successful. The restriction of computer imports meant that the only practical way for foreign computer companies to enter the Japanese market was through manufacturing in Japan. But, unable to form a wholly-owned manufacturing subsidiary, the only options available to a foreign computer company new to this market were to form a Japanese-controlled manufacturing joint venture or to license its technology (with key terms such as royalty rate and duration subject to guidance by MITI) to a Japanese-owned computer manufacturer. Meanwhile, the importance of the Japanese government's procurement policy, which was authorized by Cabinet decisions and was not officially revoked until January 1978, should not be underestimated. Most of the past generation of engineering and science students — the computer buyers of the future — was educated in national and prefectural universities using only computers made in Japan by Japanese-owned computer companies.

The American side believes that many aspects of this fivefold policy violated the rules of economic fair play set forth in the FCN Treaty (Treaty of Friendship, Commerce and Navigation) signed by Japan and the United States in April 1953. The most serious deviation from the Treaty terms was the prohibition of the establishment of wholly American-owned computer manufacturing companies in Japan. This

*Japan: *The Government-Business Relationship* (U.S. Department of Commerce, 1972)

measure was taken under Japan's foreign exchange controls, by not granting American computer companies the licenses needed to bring into Japan the capital required for establishing such subsidiaries. The reasoning was that future repatriation of dividends or capital by such subsidiaries might endanger Japan's monetary reserves. Yet Japan had agreed, in the FCN Treaty, to use foreign exchange controls to restrict outgoing remittances only (Articles VII and XII). Japan specifically agreed not to use foreign exchange controls to restrict incoming American investment, except that Japan reserved the right to provide, when necessary to protect Japan's monetary reserves, that such incoming investment would not carry a right of future repatriation of dividends or capital (paragraph 6 of the Protocol).

The American side also believes that the FCN Treaty was violated in preferring the products of Japanese-owned computer companies in procurement by the Japanese government and government-owned enterprises (Articles VII, XVI and XVII) and in excluding American-owned computer companies in Japan from some of the special tax benefits and advantageous lease arrangements made available to Japanese-owned computer companies (Articles XI and XVI). Also, there is some question whether the Treaty was violated by the conditions imposed on IBM to license its patents to its competitors (Articles V, VI and X) and to self-restrain its market share (Article VII). (It should be observed that these conditions were not altogether disadvantageous to IBM or incompatible with the strategy IBM might have chosen to follow in any event).

None of these alleged FCN Treaty violations in the computer industry continues today. However, there is an important point to be made in referring to them here. Memories of "the bad old days", in computers and in other industries as well, are part of the American business community's perception of Japan. The vehemence of its recent reaction to MITI's proposal concerning software, which apparently came as a genuine surprise to MITI, is attributable to the belief by the American business community that this proposal signalled a return to the protective policies of "the bad old days".

TSG believes that it is important for the Japanese government to be fully aware of these American perceptions. TSG also believes that the rules of economic fair play set forth in the FCN Treaty more than 30 years ago continue to be an appropriate basis for bilateral economic relations, and that both governments must faithfully observe their FCN Treaty obligations. In this regard, TSG welcomes the recent release by the Department of State (with the consent of the Government of Japan), under the Freedom of Information Act, of the negotiating minutes of the FCN Treaty. These previously secret minutes clarify the meaning of several ambiguous provisions of the Treaty, particularly paragraph 6 of the Protocol, referred to above.

Semiconductors

During the late 1960s and early 1970s the Japanese government nurtured Japanese-owned semiconductor companies by the same policy it had used in the computer industry: restricting imports, prohibiting the establishment of foreign-owned manufacturing subsidiaries, and virtually forcing foreign semiconductor companies to form Japanese-controlled joint ventures or to license their technology to Japanese-owned companies.

By the mid-1960s, however, Japan had begun to enjoy modest trade surpluses. It was becoming increasingly clear to Japan's OECD trading partners (Japan had joined the OECD in April 1964) that Japanese restrictions on incoming foreign investment were not necessary to protect Japan's monetary reserves, and that their primary effects were to protect Japanese-owned companies from foreign-owned competition and to maintain a one-way flow of technology into Japan.

Thus, under growing foreign pressure, Japan began in 1967 to liberalize its restrictions on incoming foreign investment — a process that, as of 1984, has almost been completed. From the American perspective, however, the liberalization process was frustratingly slow. It seemed that the only industries that foreigners were being allowed to enter were those in which Japanese-owned companies had already become strong enough to be able to resist market penetration by foreign-owned competitors.

The semiconductor industry is an apt illustration. Texas Instruments first sought MITI approval for a wholly-owned manufacturing subsidiary in 1964. Four years later, Texas Instruments was permitted to establish a 50/50 manufacturing joint venture with Sony, provided that Texas Instruments license its basic integrated circuit technology to Japanese-owned companies. By 1971, when Texas Instruments was finally permitted to purchase 100% control of the joint venture, all of Japan's major computer and communications equipment manufacturers had established their own semiconductor production facilities, using licensed U.S. technology. Thus it appears that those seven years of delay had the effect of significantly reducing the market share of Texas Instruments and increasing the market share of its Japanese-owned competitors. (The president of one of these competitors, Toshiba, was Acting Chairman of the Foreign Investment Council — the Japanese government's consultative organ on incoming foreign investment matters — at the time.)

It should also be noted that, until 1974, liberalization applied only to the establishment of new subsidiaries; purchases of controlling interests in existing Japanese companies by foreigners was prohibited. Thus the U.S. semiconductor companies were denied one means that they might have used — and that Japanese companies entering the U.S. market frequently use — to shorten their start-up time. The American

side believes that this prohibition was in violation of the FCN Treaty (Articles VII and XII); the FCN Treaty minutes make it clear that it was intended that American investors would have the right to purchase controlling interests in existing Japanese companies.

In 1976, MITI sponsored the VLSI (very large-scale integration) Project, a joint research project in applied semiconductor technology in which the major Japanese-owned electronics companies, but no foreign-owned companies, participated. Some ¥29 billion in government conditional loans plus considerable private funds were invested in this project between 1976 and 1979. The project resulted in more than 1000 patentable technologies, and the royalties on these patents will be used, beginning in the current fiscal year, to repay the government loans.

Today, Japanese-owned semiconductor manufacturers are very strong both technologically and financially, and they clearly have no need for further Japanese government assistance. Such assistance continues, however, particularly in the form of new government-funded research projects at the leading edge of semiconductor technology. MITI has stated that, in accordance with the February 1983 recommendations of the U.S.-Japan Work Group on High Technology Industries, American-owned companies are eligible to participate in such projects and to become licensees of any technologies resulting from such research. There have been no significant examples of such participation or licensing to date, however.

In general, Japan's semiconductor market today can be said to be completely open to American-owned companies. But, as with computers, there is an important point to be made in referring to the problems of the past. Namely, the reduced market share of Texas Instruments — which resulted from Japanese government-imposed delays in the establishment of its manufacturing subsidiary in Japan and from Japanese government-required licensing of its technology to Japanese-owned competitors — still persists today. Lingering effects such as this are significant, not just in the semiconductor industry but in many industries, high-technology and otherwise. Investment opportunities denied in the 1950s, 1960s and 1970s have become trade opportunities denied in the 1980s. Indeed, trade frictions and trade deficits today might present a far different picture if Japan had begun permitting U.S. investment in 1953, when the FCN Treaty entered into force.

Communications Satellites

Japan's space development efforts began in earnest in the late 1960s, with the establishment of NASDA (the National Aeronautics and Space Development Agency) under the Science and Technology Agency. In the beginning, NASDA was almost completely dependent on technological assistance from America's NASA. There was, and still is, a

master agreement between NASA and NASDA under which numerous technological tie-ups have been concluded between Japanese and U.S. companies for the provision of the equipment and technology needed for NASDA's programs. However, all of these private sector tie-ups are subject to stringent restrictions imposed by NASA on the basis of U.S. national security considerations. For example, products manufactured under the technology are subject to U.S. export controls, which also cover Japan's use of the technology for the purpose of launching third countries' satellites.

In 1978, the Space Activity Committee, an advisory committee to the Prime Minister's Office, announced a 15-year plan for pursuing unrestricted space development based on self-reliance in space technology. Under this plan, NASDA has given preference in its procurement to satellites with high local content. As a result, U.S. satellite manufacturing companies have had to enter into joint manufacturing arrangements with Japanese companies in order to sell satellites to NASDA. Since 1978, most of the satellites purchased and launched by NASDA have been manufactured in Japan under such arrangements, and the proportion of the technology and components supplied by the Japanese side has increased to an estimated 60-65% in current projects, such as the CS (communications satellites) series.

To the extent that these satellites are purchased by NASDA for operation by government-owned enterprises such as NTT (Nippon Telegraph and Telephone Public Corporation) and NHK (Japan's public broadcasting network), there is a question whether NASDA's preference for satellites with high local content accords with Article XVII of the FCN Treaty, which provides that government-owned enterprises of either country shall make their procurement decisions solely in accordance with commercial considerations and shall give suppliers from the other country an adequate opportunity to compete.

There are no Japanese private-sector operators of satellites at present, but it is quite possible that such operators will emerge in the near future. Two private consortia are now studying the feasibility of satellite operation, as one of several possible media for telecommunications. The Japanese government's package of market-opening measures announced in April 1984 contained a statement to the effect that the purchase of foreign-made, foreign-launched satellites by private firms, and by NTT and other government-owned enterprises and government agencies as well, will not be restricted, provided that these purchases are consistent with Japanese space development policy. The effect of that qualification remains to be seen.

Software

The 1983 TSG report entitled *Japan: Obstacles and Opportunities* identified the software industry as one in which the United States had a clear competitive advantage over Japan and encouraged U.S. software firms to enter the Japanese market. Shortly thereafter, MITI proposed a new law for the protection of software rights. MITI's proposed law would overrule recent court decisions placing software under the protection of the Copyright Law, administered by the Ministry of Education, and instead would place it under the protection of a new "Program Rights Law", to be administered by MITI.

The reaction of the American business community was immediate, since it believed that the proposed law was an attempt to change the "rules of the game" to benefit Japanese software users at the expense of American software developers. In particular, the American side objected to four provisions of the proposed law: (a) shortening of the period of protection from 50 years under the Copyright Law to a proposed 15 years, (b) compulsory licensing of programs that have not been used for a certain period of time, (c) compulsory licensing of programs to developers of improvement programs, and (d) registration of programs with MITI, which would require filing complete copies of programs and source codes with MITI.

In response to these objections, MITI has stated that: (a) 15 years should be long enough to allow for the recovery of a software developer's investment, though MITI will consider a different period of protection if this seems to be the international trend; (b) compulsory licensing of unused programs is necessary to prevent abuse of the developer's right, and a fair royalty would be paid to the developer; (c) compulsory licensing to developers of improvement programs would apply only in cases of substantial improvements, and a fair royalty would be paid to the original developer; and (d) registration of programs would not be necessary in order for "program rights" to exist, but rather would be a voluntary step taken by the developer, the effect of which would be to establish a rebuttable presumption of priority of development, and in any case copies of programs and source codes filed with MITI would be kept confidential.

After discussions between MITI and the Ministry of Education, which has been considering modifications to the Copyright Law that would strengthen its coverage of software, it was decided that "further coordination of various viewpoints about the protection of software rights will be made in search of better ways of protecting such rights, noting the need for international harmony."

Thus it still unclear what changes will ultimately be made. The Japanese government has stated, however, that it intends to consult with the United States concerning any such changes.

TSG, while not wishing to take sides in a jurisdictional dispute between two ministries, nevertheless believes that it would be best for MITI to abandon its proposal for a separate law and instead to cooperate with the Ministry of Education in strengthening and improving the protection of software under the Copyright Law.

TSG also believes that, given the increasingly close but also increasingly sensitive economic relations between the United States and Japan, bureaucrats of one country, in drafting new laws or regulations that will have an international impact, should seek the opinions not only of businessmen of their own country, but also of businessmen of the other country. The software issue may stand as an example of the frictions that are likely to result if this rule is not observed.

Telecommunications and Information Technologies

The sole provider of telecommunications services within Japan is NTT, a government-owned enterprise. NTT does not operate manufacturing facilities of its own, but rather obtains all its supplies through procurement, currently running at about \$2.5 billion per year. Until 1981, NTT had a closed procurement system, with the bulk of its purchases being made from four companies: Fujitsu, Ltd.; Hitachi, Ltd.; NEC Corp.; and Oki Electric Industry Co. These companies and some 200 subsidiaries and affiliates (the "NTT Family") provided all important equipment for the operation of Japan's telecommunications system. In addition, through the NTT laboratory system, these companies participated in joint research and product development.

Before 1981, NTT procurement from foreign suppliers was at most a few tens of millions of dollars worth a year. In contrast, U.S. telephone companies were purchasing hundreds of millions of dollars a year worth of equipment from Japanese suppliers. (Currently, the figure is estimated to exceed \$1 billion a year and is growing, particularly as a result of the breakup of AT&T.)

This situation led to the U.S.-Japan Agreement on Telecommunications Procurement of December 1980, intended to open the NTT market. Effective from 1981, the Agreement called for a bid tender system that would give access to much of NTT's new procurement. The revision of the Agreement, effective from 1984, also covers new research and development projects. Ongoing procurement and ongoing research projects are not covered by either the original Agreement or its revision.

After a slow start in JFY 1981 (the Japanese fiscal year beginning on April 1, 1981), a number of U.S. companies began investing substantial money, engineering effort, and managerial time into attracting NTT orders. These companies have found that it is still extremely difficult to identify exactly when a new product, open to all bidders on an equal

basis, emerges in the NTT system. Progress toward any appreciable increases in procurement orders has been slower than expected.

Unfortunately, measuring such progress is difficult, because both governments have recently begun reporting the statistics concerning NTT procurement from foreign companies on the basis of "orders placed" rather than on the more usual basis of shipments received and paid for. Such statistics look impressive, but they cannot be compared directly with statistics for overall NTT procurement or for Japanese equipment sales to American telephone companies, or even with NTT overseas procurement figures for the first two years of the Agreement. With this caveat, the figures are: JFY 1981, ¥4.4 billion (\$20 million); JFY 1982, ¥11 billion (\$49 million); and JFY 1983 ("orders placed" basis), ¥34.8 billion (\$155 million). Thus it does appear that there have been increases in NTT procurement from American companies, but it still appears to be less, by several orders of magnitude, than Japanese equipment sales to U.S. telephone companies.

This is not to suggest that NTT's procurement from U.S. suppliers must necessarily be equal to U.S. telephone companies' procurement from Japanese suppliers. All that Article XVII of the FCN Treaty requires is that NTT should make its procurement decisions solely in accordance with commercial considerations and should give U.S. suppliers an adequate opportunity to compete. However, to the extent that NTT did not observe this standard in its past procurement, it is appropriate that NTT should engage in "affirmative action" in its current procurement, with the objective of giving to U.S. companies approximately the market share that they would have enjoyed if NTT had observed the Treaty standard all along. In this regard, TSG highly evaluates the steps taken by NTT such as the preparation of explanatory materials in English, the acceptance of applications (bids) in English, and the acceptance of applications at NTT overseas offices.

Legislation before the Diet at mid-1984 would transform NTT from a public corporation, wholly owned by the Japanese government, into a stock corporation, only partially owned by the government. Although the text of the proposed legislation has been available for some time, the implementing regulations are still in the drafting stage, and therefore it is unclear what changes, if any, there will be in the NTT procurement system. TSG hopes that any changes will be in the direction of more, rather than less, access by foreign suppliers.

Another proposed law before the Diet at mid-1984 would abolish part of NTT's telecommunications monopoly by allowing private companies to establish and operate VANs (value-added networks). Again, the implementing regulations are still in the drafting stage, but it does appear that participation by foreign-owned companies in the liberalized communications services will be restricted in several respects, such as the operation of mobile and cellular radio systems, or any activity that involves running a line or a microwave link across a public thoroughfare. As applied against American-owned companies, such restrictions would not necessarily violate the FCN Treaty, because both countries reserved the right to restrict foreign investment in enterprises engaged in furnishing communications services to the general public. However, such restrictions might violate the OECD Code of Liberalization of Capital Movements, because Japan, unlike the United States, did not reserve communications services under the Code. In any event, TSG believes that Japan should aim at opening its communications services market to American and American-owned companies to the full extent required by applicable treaties, or, if greater, to the same extent that the U.S. communications services market is open to Japanese and Japanese-owned companies.

* * *

Today, Japanese companies have become world-class competitors in many high-technology industries. The extent to which these successes have resulted from Japanese government strategy may vary from industry to industry, but one point underscored by these case studies is that, owing to Japanese government strategy, American and American-owned companies have been permitted to play a far lesser role in creating and participating in these successes than would have been the case in a free market. TSG believes that it is time for a new Japanese government strategy — a strategy that (a) does not discriminate between companies that are Japanese-owned and those that are American-owned, recognizing that the latter as well as the former can play a constructive role in the further development of Japanese high technology, and (b) obviates U.S.-Japan trade frictions by promoting fair and equal access of U.S. goods and services to Japan's high-technology market. In certain cases, it may also be appropriate for the government to engage in affirmative action to overcome the lingering effects of past discrimination.

Chapter 6

INTELLECTUAL PROPERTY

Intellectual property includes such intangible but highly valuable assets as the inventions underlying a company's technology, its proprietary information, the styling of its products and the brand names and symbols that ensure recognition of its products by the public.

These forms of property can be legally protected in most industrial countries by patents (for inventions), design registrations (for product styling), trademarks and service marks (for product or company identification), copyrights (for works of authorship) and trade secrets laws (for confidential business and technical information).

Security of the inventor's rights to his own inventions and of a company's rights to its own processes, products, services and confidential information are the cornerstone of technological and commercial development in a free-enterprise economy. It is equally important to the development of trade and direct investment among nations.

The administration of Japan's intellectual property laws is generally recognized to be even-handed, treating domestic and foreign companies alike. It is also true that the multi-lateral treaties for protection of industrial property require only such even-handed treatment—not reciprocal treatment.

Nonetheless, there are features of Japanese industrial property laws and their administration that tend to discourage foreign companies that wish to export to or establish facilities in Japan, and other features that in practice bear harder on foreign companies than on domestic ones. The principal problems as perceived by TSG are surveyed in this chapter, along with some possible remedies.

PATENTS

Japan's Patent System

In Japan, as in most countries that have patent systems, rights to a patentable invention belong to the first to file a patent application, whether or not that applicant is the first inventor. (In the United States, the first to invent is entitled to the patent even if others have filed applications before him.)

Eighteen months after filing in Japan (or 18 months after the priority date of an application from abroad), the as-yet unexamined application is published for public inspection. It is examined for patentability if the applicant so requests within seven years after filing. (Currently, examination is

requested for about 69% of all applications filed.) If on examination by the Japanese Patent Office (JPO) an application in its final form appears acceptable, it is published in JPO's *Official Gazette*.

Anyone may then file an opposition, informing JPO of reasons why the invention is not patentable (such as lack of novelty due to previous publication of its description, or public use, or obviousness to specialists in the field involved). If the JPO examiner rejects an application, or approves it but then makes a rejection on the basis of an opposition, the applicant can appeal to JPO's Board of Appeals and ultimately to Tokyo High Court.

Besides patents, Japan also allows the registration of "utility models", covering relatively simple inventions that involve the shape or construction of articles—not processes or methods. Similar in subject matter to German "petty patents", utility models are judged by less strict criteria of invention than are used for patents, and protection is for a shorter term. Utility model applications are examined by the same procedure used for patent applications, and by the same examiners.

Slowness of Patent Registration

Perhaps the greatest problem of Japan's patent system is its slowness. According to JPO, it now takes an average of two and a half years from the time an applicant requests examination to the JPO examiner's decision to accept or reject the application. But for new cases this is preceded by a year or more of initial processing and publication. Then routine appeals can take another two or three years, and the opposition process often adds a year or more. There is often a final delay of six to nine months between JPO's decision to grant a patent and its official registration.

A random check of the patent registrants' index by one American patent specialist in Japan suggests that the typical Japanese patent is issued about six years after the application is filed. For comparison, the average time required for issue of a U.S. patent is now about two years after filing, and the stated goal of the U.S. Patent & Trademark Office (USPTO) is to reduce the average time to 18 months by 1987. JPO, however, believes that the six-year estimate noted above is much longer than the typical period.

As an example of processing time in various countries, one TSG member filed a patent application in Japan in De-

cember 1976, after which corresponding applications were filed abroad. A patent was granted 12 months after application in the United Kingdom. The U.S. patent was issued in 36 months. Figures for other countries of filing were 45 months for Canada, 62 months for Israel and 70 months for Australia (where a clerical error in the patent attorney's office delayed issue). As of June 1984, the Japanese application is still pending—90 months after application.

During the long wait for legal protection of an invention after the patent application is filed and published for public inspection in Japan, the applicant is vulnerable to unauthorized copying of his invention by competitors. This is especially true of industrial processes, which a copier can use in his own plant, out of the public eye. Unlike the United States, Japan provides no discovery procedures whereby the courts assist a plaintiff in obtaining proof that his process is being used in a defendant's plant.

Because a U.S. company's competitiveness often rests on its proprietary technology, the slowness of gaining legal protection in Japan of the inventions underlying this technology, together with exposure to copying by competitors due to the early publication of unexamined patent applications, can act as a brake on both U.S. exports to Japan and direct U.S. investment in manufacturing facilities in Japan. This applies particularly to high-technology inventions, for which the effective product life may be only two to four years. Nor is technology that is merely "patent pending" very saleable to prospective licensees in Japan.

Reasons for Slowness and Recommendations

1) Huge volume of applications

JPO annually receives by far the largest number of patent applications filed anywhere in the world—well over twice the number filed in the United States. Adding in the applications filed in Japan for utility models (which play no part in the U.S. patent system) swells the annual volume to nearly five times the number of filings in the United States.

Japanese companies—especially large corporations—account for the bulk of patent and utility model applications filed in Japan. In 1982, just over one-quarter of the year's applications were filed by Japan's ten largest companies alone. The top 50 companies accounted for 45.5% of all filings (Foreign applications were 5.9% of the total, and applications by Japanese individuals and not assigned to companies were 8.9%).

The first-to-file system of patent registration encourages rush filing of an application as soon as the inventor decides that his invention possibly is patentable and can be commercialized. A thorough screening for "prior art" (such as published descriptions of the same subject matter, or evidence of prior public use) that would make his invention unpatentable takes time and often costs the inventor more than filing the patent application. Moreover, prior art dis-

closure requirements are generally not as strict as in the United States—less written detail is necessary to support the patent application.

In addition, JPO notes, the ratio of patent and utility model applications actually filed to invention proposals within a company is high in Japan, so as "to encourage the inventive skills of employees". The stringent cost-benefit evaluation made by U.S. and European companies before deciding to file a patent application, JPO suggests, is not common practice in Japan.

Since the mid-1970s, JPO has been urging Japanese companies to shift "from quantity to quality" of applications—to reduce their prolific filing by a more thorough filing search for prior art; stricter selection of invention proposals for which applications are filed and examination requested; and self-discipline in filing applications of low technical or economic value.

Another factor in the huge volume of Japanese applications, however, is JPO's own preference for single-claim applications. Related inventions may be claimed in a single application under Japan's Patent Law (Art. 38), but the criteria actually applied by individual examiners for acceptable combinations of claims are unpredictable, so that multiple-claim applications often need to be split into separate cases during examination. Moreover, in contrast to U.S. and European practice, no claims in an issued multiple-claim patent are enforceable as a practical matter while being contested. Japanese companies therefore tend to file several patent applications to cover different aspects of a single inventive concept.

2) Understaffing of JPO

The annual volume of applications that JPO will be called upon to examine is now roughly 2.5 times the number filed with USPTO each year. Yet JPO's staff of patent and utility model examiners is still only three-quarters the number of USPTO's patent examiners. Despite the 5% to 10% annual growth in number of applications in recent years and its "pay-as-you-go" fee collection, JPO has not been exempted from the Japanese government's policy of civil service staff reduction. As a result, the number of patent and utility model examiners and appeal examiners has remained virtually unchanged for the last 10 years.

Utility model applications, though gradually declining in proportion to patent applications and hardly used at all by foreign applicants, still represent almost half the caseload of JPO examiners. In the 19th century, these "petty patents" were included in Japan's intellectual property protection system to encourage the widest possible participation in industrial innovation by Japan's infant industries. To illustrate their difference from patents, JPO cites two camera improvements. The invention of an automatic exposure control mechanism involves new technology suitable for patent protection. But a clip that facilitates the mounting of a view-

finder on the camera is an object suitable only for utility model protection.

Today, the continuing existence of the utility model system is a needless duplication of JPO effort and a drain on examiners' time. Given the crisis size of the backlog of applications facing JPO, TSG believes that de-emphasis of utility models — at least to the extent of adopting the German practice of not examining this class of petty patents, is the only realistic alternative to an immediate doubling of JPO's staff of examiners.

JPO is launching in fiscal 1984 a 10-year program to automate much of the examination process, aiming for a paperless information-handling system by 1993. Machine-readable applications will be accepted from fiscal 1988, according to JPO's schedule, though electronic file processing will not actually begin until about 1991. Meanwhile, the massive backlog of patent and utility model applications (now more than 440,000) awaiting examination will surely continue to grow unless further steps are taken — including a major expansion of JPO's staff of examiners. To secure other experienced examiners, arrangements might also be made to take on retiring specialists from such government organizations as the Science and Technology Agency.

3) Inefficient examination practices

The slowness of JPO's examination process due to understaffing and lack of automation is compounded by inefficient examination procedures. The JPO patent examiner, notes a comparative study of JPO, USPTO and European Patent Office practice issued earlier this year by the Committee on International and Foreign Law of the American Patent Law Association (APLA), "carries an extremely heavy workload of applications, and is given very wide latitude and independence in determining how he handles the prosecution of these applications".

In Japanese practice, when the examiner discovers a flaw in an application — whether a fundamental defect or a minor procedural error like a mistransliteration of the applicant's name — he issues an "office action" (notice to the applicant of the deficiency) and stops work on that application pending a response. When examination is resumed, the discovery of a second flaw results in another office action — and so on, one objection at a time. Typically, it takes two months for each office action, usually handwritten, to be logged and mailed by JPO to the applicant. Examination does not necessarily resume immediately after receipt of the applicant's response. In the interim, a change of examiner and delays of a year or more are common.

By contrast, USPTO practices "compact prosecution". The examiner notes deficiencies in an application but must continue examination unless a fundamental defect is discovered. All objections must be included in the examiner's first office action, which may mean that the

applicant can remove all objections to patentability in a single response.

Another problem is the brevity of JPO office actions, which often consist of a checked box on a multiple-reply form with little explanation added. Detailed reasons for rejection are seldom given. References to the publication numbers of published prior art (as a basis for rejection) are given, but the examiner seldom specifies the relevant passages in the reference, and copies of the references are not furnished with the office action. (USPTO usually specifies the passages to be noted in its references, and copies of those references are always attached. In Japanese practice, apparently continuing the tradition of times before inexpensive photocopying became widely available, not even the JPO's own case file for a given application contains copies of the references cited in office actions.)

Unlike USPTO practice, further, the JPO office action does not indicate allowable subject matter and claims. The inexplicitness of JPO office actions delays the framing of a suitable response by the applicant — and adds to the volume of appeals.

The lack of completeness of JPO office actions, ranked in APLA's comparative study as "by far the most important difference/problem area" of JPO practice, typifies those practices that needlessly delay the prosecution of patent cases — whether computerized or not. Complete, fully specific office actions would not only speed the prosecution of applications, but would likely reduce as well the backlog of appeals — now three times the annual volume of new applications and still rising. Unclear office actions easily lead to "unsatisfactory" responses by applicants, resulting in the examiner's rejection of the application and the applicant's being compelled to file an appeal to save his rights to the invention in Japan.

It is not evident that JPO's newly-launched long-term computerization program will in itself eliminate these inefficiencies in examination. JPO's past record of adapting its scheduling, procedures and forms to take advantage of such earlier basic improvements in office equipment as the Japanese typewriter, photocopying machines, electric filing cabinets or computer systems for simple record-keeping is not impressive. It may be questioned how successful JPO's transition to "paperless processing" can be without the introduction of more sophisticated examination procedures along with the new computers and work terminals.

TSG is concerned about JPO's priorities in embarking upon a \$520 million (¥120 billion) computer acquisition and building construction program aimed at comprehensive machine processing a decade hence without first expanding the staff of examiners and appeal examiners so as to begin reducing the already huge backlog of pending cases that is so seriously delaying patent protection for applicants today.

Difficulties of Foreign Applicants

While slowness in the prosecution of applications is a burden on all patent applicants, some features of JPO practice pose greater difficulties for foreign applicants than for Japanese.

1) Language

All communications to and from JPO must be translated from and to the foreign applicant's language, and Japanese-language references cited in JPO office actions must also be translated. This is an unavoidable fact, and the additional time required for translation is recognized in JPO's extension of certain deadlines for foreign applicants. Response to an office action, for example, must be made within four months by foreign applicants, while domestic applicants have only 40 days to respond. (USPTO allows six months for response.)

No extension of deadline, however, is permitted for initiation of oppositions by overseas parties. Once a patent application is published in JPO's *Official Gazette*, those who wish to cite prior art against the invention's patentability have only two months to initiate an opposition. (Additional time is allowed for submission of exhibits.) For a person or company outside Japan to be alerted to the gazetted application, obtain a translated text, and decide to file an opposition brief within the two months allowed can be particularly difficult.

Yet the opposition process is important in protecting one's existing product line in Japan against preemption by an about-to-issue Japanese patent. This is especially so because applicants for Japanese patents are under no legal obligation to disclose all relevant references and other information that the JPO examiner should take into account in judging patentability. Defeating a patent or forcing a restriction of its claims at the opposition stage avoids a four-year invalidation trial against an issued patent. TSG believes that four to six months is a more reasonable deadline for filing an opposition. This extension would greatly benefit overseas applicants without denying registration to any truly patentable Japanese application.

Another language-related matter is the JPO requirement that all applications must be filed in Japanese. (USPTO accepts emergency applications in languages other than English, if followed by an English translation up to four months later. Several countries where the native language is not in international use allow filing of applications from abroad in major languages.)

A key problem raised by the Japanese-language filing requirement is the overly strict attitude of JPO examiners toward defects — including minor errors in translation — in applications.

An American inventor typically files a Japanese application almost a year after his original U.S. filing. (By a multilateral treaty to which both the United States and Japan are

parties, he may file in Japan within 12 months of his earliest filing in a treaty country and receive the same effective date (the "priority date") as that of his earliest filing.) That year's time is used to recast the application into a form suitable for Japanese filing and to have it translated into Japanese. JPO allows 15 months after the priority date for the applicant to make "discretionary" amendments — such as correcting errors in translation. This means the typical American applicant has only three months following the actual filing date in Japan to detect such errors and have them corrected. (USPTO allows discretionary amendments at any time before or during examination, and frequently pending appeal after final rejection.)

Even if a mistranslation or typographical error is found by the applicant, JPO may not allow its correction if the amendment appears to alter the nature of the invention claimed. In a case appealed to Tokyo High Court and decided in March 1983, for example, a U.S. applicant discovered that the word "bromine" had been mistakenly written by the Japanese patent attorney instead of the correct word "boron" throughout the Japanese-language application. Amendment to correct the error was sought. The foreign applicant correctly pointed out that the mistranslation was obvious. But JPO refused amendment, ruling that the change of words would materially change the invention as claimed in Japan. On appeal, Tokyo High Court sustained the JPO ruling. In a similar case five years earlier, the same court sustained JPO's refusal to allow change of the mistranslation "polyvinyl acetate" to the correct "polyvinyl acetal" in an application from abroad. A more liberal policy toward discretionary amendments, especially those regarding inadvertent flaws in translation, would be a significant step toward fully equitable treatment of foreign applicants.

2) Priority date deadline

To obtain the earliest date of filing (usually that in his home country) as the priority date of an application filed abroad, an inventor must provide a certified copy of his original application. USPTO accepts these certified documents from foreign applicants at any time during patent prosecution up to the due date for the issue fee. But the JPO deadline is three months after actual filing in Japan. By statute, no exceptions are allowed, even if a delay is due to slowness of the home country patent authorities in issuing the certified copy or to their issuing a copy in some way defective. Yet loss of priority date can result in loss of all rights to the invention in Japan.

3) Deadline for foreign prior art as grounds for invalidation

Novelty is a prime requisite for patentability of an invention. If it can be shown that the subject matter of an issued patent was published before the application for the patent was filed, there are good grounds for a JPO trial to invalidate the patent. Generally, prior publication anywhere in the world is

sufficient to challenge a Japanese patent.

Japan's Patent Law (Art. 124), however, discriminates procedurally between domestic and foreign prior publications. Publication in Japan prior to the filing of the Japanese patent application can be cited to invalidate a patent. The same is true of prior publication outside Japan — but only if the challenge is made within five years after issue of the Japanese patent. This provision establishes a "statute of limitations" on defensive use of foreign prior art — an unusual discrimination that can act against the legitimate interests of an overseas company or inventor attempting to operate in the Japanese market.

4) Lack of foreign access to JPO's planning process

There has been a substantial increase in JPO's participation in international bodies, forums and exchanges in recent years. Growing assistance has also been extended to patent office officials of less-developed countries, particularly those in the Pacific Basin.

Yet major changes in JPO's own procedures and policies are announced to foreign applicants as a *fait accompli*, despite the fact that foreign inventors comprise 10% of JPO's applicants. For example, no foreign companies or specialists were invited to participate in formulating realistic goals and means for JPO's sweeping computerization program.

In February 1984 JPO held its first conference ever with senior corporate patent attorneys invited from the United States. (The 21 U.S. firms involved file about one-quarter of all foreign patent applications received annually by JPO.) The invitees were briefed about Japan's industrial property system and JPO's computerization plans, the conference ending with announcement of an "open door" policy under which, for example, foreign applicants can now visit JPO and discuss their cases directly with examiners or appeal examiners. (In past practice, only Japanese proxies could approach examiners about cases filed by foreign applicants.)

TRADEMARKS

Japan's Trademark System

As in many countries, rights to a trademark in Japan belong to the first to file for its registration. In filing his application, the applicant must state that he engages in a business recognized as related to the goods for which registration of the mark is requested. Documentation of that fact, however, is generally not required. (Renewal after each ten-year registration term does require a demonstration that the mark has been in use sometime in the past three years.)

In the United States, by contrast, rights to a trademark belong to the first to use it commercially, and such use in interstate commerce is necessary before the mark can receive federal registration. As one Japanese legal authority puts it,

trademarks in the American view are symbols appearing on goods to show their origin, while in the Japanese view they are symbols on a registration document — remaining trademarks even if not used.

Prosecution of trademark applications by JPO follows almost the same procedure as that for patents and utility models, described in the previous section. The differences are that all trademark applications are examined (there is no request system), and applications are available for public inspection, even prior to JPO examination.

As with patents, so with trademarks: JPO leads the world in annual volume of applications — three times the number filed in the United States. Unlike the patent application flood, however, the volume of trademark applications has receded somewhat in recent years. After peaking at about 200,000 in 1973, applications dropped to 118,000 in 1979. Some 150,000 were filed in 1983.

Although Japan's prolonged business recession is a factor, the slower rate of trademark applications is attributable in good part to amendments to the Trademark Law enacted in 1975 and fully effective since mid-1978. These changes added the requirement that use be demonstrated before a trademark registration can be renewed. They also shifted the burden of proof regarding use from the plaintiff to the trademark owner in the case of cancellation trials brought for non-use. Previously, speculative filing of marks for later sale to prospective users was an active business among individuals and small firms acting as trademark brokers. During the drafting of the 1975 amendments, JPO estimated that 70% of all Japanese trademarks then registered were not in use.

The lower rate of filing in recent years has allowed JPO examiners to make some inroads into the backlog of applications. From over half a million in 1975, applications awaiting examination fell to 389,000 by the end of 1982.

Trademark Problems

1) Slowness of registration

Although the inflow of new applications has moderated, the backlog remains large and prosecution of trademark cases is slow. From filing to registration typically requires four years or more. (USPTO averages about 22 months for registering a trademark, and has a stated target of 13-month average registration time by 1985.)

A lengthy wait for protection of a company's distinctive marks is a particularly serious drawback for foreign firms seeking to introduce their products to the Japanese market. With initial promotion, marketing and start-up costs to justify, such companies need prompt registration of a relatively few trademarks. Japan's slowness of registration favors firms already established in Japan, which can better afford strategic filing of numerous trademarks well in advance of expected need.

As in the case of patent prosecution, understaffing is one root of the slowness problem. The number of JPO trademark examiners has remained virtually the same since 1975. Expanding the staff of examiners is the logical means of removing this obstacle to inward trade and investment growth within a reasonable time.

2) Registration of well-known foreign trademarks by other parties

The first-to-file system allows one to register in Japan trademarks already in use by others overseas. JPO can reject registration of a trademark if the mark is "well-known" in Japan, but "well-known" is interpreted to mean well-known to Japanese consumers in general — a condition that is often difficult to prove. For better protection of foreign trademarks in Japan, TSG recommends that a more realistic standard for refusing registration to another party be adopted. Such a standard might be that the mark is "already known, to those in Japan dealing in such goods, to be another's trademark that is well-known abroad, in a country party to the Paris Convention for the Protection of Industrial Property".

3) Refusal to renew slightly altered marks

During the ten-year term of a trademark registration, the owner may well modify the mark in some way, so that the specimen of use presented to JPO in support of renewal is not identical with the registered mark. The problem here is JPO's unusually strict criteria for use of the registered version, by which very slight changes in the mark in use are possible grounds for refusing its renewal.

TSG suggests an approach that would eliminate this problem without going beyond the framework of present JPO practice. It would allow an applicant who has altered his registered trademark during use to include with the renewal application an associate trademark application for the altered version. (In Japan, an associate trademark application can be filed for a mark similar to the applicant's own registered trademark and used on the same goods.)

If the associate trademark is approved for registration as being sufficiently similar to the original registered mark, then the original mark would be granted renewal as well.

4) Non-use of International Classification System

A registered trademark cannot be used on any type of goods its owner wishes, but is restricted to goods in a specified trademark class designated in the registration. The United States and the major European countries, as parties to the Nice Agreement*, use an international classification system for trademarks. Japan, not a party to the Nice Agreement, uses a unique classification system of its own. Last revised in 1960, it does not specifically list many recently invented goods, so that considerable interpolation is required. (When trademark renewal is due, marks registered

under older versions of this system — going back to the 19th century — are not reclassified.)

Separate applications for a given trademark may be filed in all appropriate classes of goods, but the most appropriate choices for a given line of business is often a perplexing matter. Adopting the International Classification of Goods and Services would eliminate many of the difficulties of classifying modern goods for trademark registration in Japan — and would at the same time provide Japan with a system for classifying service marks, which are discussed in the next section.

5) Lack of three-dimensional trademark protection

Another limiting feature of Japanese trademark protection is JPO's practice of restricting registration to two-dimensional marks. One can apply to register a two-dimensional representation (such as a photograph) of a three-dimensional mark such as a distinctively shaped perfume bottle, but the scope of protection of such a registration is uncertain and it presents renewal problems. Despite JPO's present interpretation, there appears to be nothing in the legal definition of "trademark" that would deny the validity — and thus the registrability — of a three-dimensional mark. TSG suggests the extension of protection to include such trademarks since in many cases alternative protection under Japan's copyright and design laws is not available since long use in business outside Japan has obviated the "novelty" required for such registrations.

SERVICE MARKS

Trademarks are identifying symbols used on a company's goods. Service marks are the equivalent for service companies, used in business transactions and advertising by airlines, travel agencies, leasing firms, consultants and other suppliers of services rather than goods.

Despite the present importance and continuing rapid growth of the services sector in the economies of Japan and its major trading partners, Japan has no nationwide registration system to protect service marks as can be done for trademarks.

TSG believes that the extension of nationwide protection to include this important category of industrial property is urgently needed to encourage the development of inward trade and direct investment.

TRADE SECRETS

Trade secrets are information used in a company's business which gives the user an advantage over competitors who do not have or use such information. A company's trade secrets might include such information as the chemical for-

* Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks

mula of a product, its list of customers, the pattern for a machine, or a marketing technique.

Japanese companies daily create, use, buy and sell trade secrets. The Japanese government taxes profits made from licensing trade secrets, and Japanese accountants can list them on balance sheets when they are either purchased or received as consideration in exchange for stock. Yet, except for the contractual enforceability of a non-disclosure agreement, legal protection of trade secrets is weak or nonexistent in Japan. In Japan's system of civil law, which emphasizes statutory law, there is no special statute that defines "trade secret" — its qualities as a form of property, the means for acquiring it, or the extent of and mechanism for its protection.

Trade secret protection is vital to the U.S. information-

processing industry and in many other lines of business in which foreign companies are attempting to compete in Japan. Lack of such protection makes these companies reluctant to import their most competitive technology and business techniques to Japan, lest their proprietary information suffer unauthorized exposure in such an uncertain legal environment.

Japan is the only major industrial country without effective legal protection for trade secrets. It would be most helpful in protecting the proprietary information of foreign companies and their licensees in Japan if suitable legislation were enacted — either along the lines of the German Unfair Competition Prevention Law or the more recent U.S. model law, the Uniform Trade Secrets Act.

Chapter 7

STRUCTURALLY DEPRESSED INDUSTRIES

Japan's structurally depressed industries have become a new focus of bilateral trade friction during the past year. These are industries that have experienced serious structural problems, mainly due to large increases in the cost of imported energy and raw materials and decreases in domestic and/or export demand. Most are basic materials industries such as petrochemicals, fertilizer, paper, textiles, and aluminum.

The importance of these troubled industries is evident from the great size of their markets in Japan, estimated to be some \$80 billion in total. To Japan, these industries retain an important place in the nation's economy, but it is generally accepted that they must be restructured in accord with the changed state of the world economy. In the view of the United States, which is price-competitive in basic materials, these industries offer a major trading opportunity which is frustrated by protectionist Japanese government policies and restrictive Japanese business practices.

Because of the sensitivity of this issue, TSG wishes to emphasize two points about the discussion in this chapter. The first is that all advanced nations have policies for dealing with the problems of their depressed industries. There is a wide range of such policies, and in many cases they have generated controversy over real or alleged protectionism. The United States is no exception, and later in this chapter there is reference to American policies. Because the purpose of TSG is to study questions of market access in Japan, however, the emphasis here is on Japan. The second point is that, as noted in what follows, there are a few points on which complete agreement has not been reached within TSG. But a substantial degree of consensus has been achieved, and TSG hopes that its findings and recommendations will help to reduce bilateral friction over trade in products of the depressed industries.

Japan's Industrial Restructuring Law

Trade friction resulted from the enactment in 1983 of a revised and strengthened version of Japan's industrial restructuring law. Formally titled the the Temporary Measures Law for Structural Adjustment of Specific Industries, it replaced the previous Temporary Measures Law for Stabilization of Specific Depressed Industries, which was in effect from 1978 to 1983.

Like its predecessor, the new law makes an industry eligible for government help if it suffers from severe overcapacity and high energy and raw material costs, and if firms accounting for two-thirds of the industry's output petition for relief from the ministry in charge, in most cases the Ministry of International Trade and Industry (MITI). Once an industry is designated as structurally depressed, the Ministry consults with manufacturers, labor, customers, and consumers, and then drafts a restructuring plan. The plan prescribes the amount of capacity that should be eliminated, based on an analysis of medium-term supply/demand projections. Producers that agree to reduce capacity can receive government loan guarantees and tax benefits. If firms do not act individually, the law authorizes the Ministry to instruct the firms to form industry-wide capacity-scraping cartels that are exempt from the Antimonopoly Act, subject to prior consent of the Fair Trade Commission. In neither case, however, are firms compelled to participate in the restructuring plan.

In addition to these measures, the new law puts more emphasis on revitalization efforts. It provides government support for the introduction of new products and technologies, and encourages mergers and other joint actions to promote more efficient production and marketing. These joint actions are not exempt from the Antimonopoly Act, and must have Fair Trade Commission approval.¹⁾ Currently, 22 industries have been designated as structurally depressed under the law. Of these, cartels have been established in five.²⁾

¹⁾ *Sankouhou No Kaisetsu* (MITI, 1983) provides a detailed explanation of the restructuring law (Japanese language only).

²⁾ These officially depressed industries include the 11 designated under the old law (electric-furnace steel, ferrosilicon, aluminum smelting, container board, urea, ammonia, wet-process phosphoric acid, polyacrylonitrile staple fiber, polyester staple fiber, nylon filament, polyester filament), and 11 newly-designated industries (paper*, fused magnesium phosphate, compound fertilizer*, viscose fiber, ethylene*, polyolefins*, ethylene oxide, rigid PVC pipes, PVC resin*, cement, sugar refining). Cartels have been established in those marked with an asterisk.

Differing Views of Trade Impact

The United States contends that Japan's policy has the effect of protecting its depressed industries from low-price import competition. In essence, the U.S. argument is that imports are restricted by the competition-limiting cartels authorized by the restructuring law, and by MITI's administrative guidance. Official restructuring plans, the United States says, equate capacity with domestic demand, leaving imports out of the calculation. The United States also contends that lack of transparency in Japan's policy-making process facilitates collusion between government and business to restrict imports. As evidence of protectionism, U.S. officials say that, despite considerable price advantages, imports have achieved significant market penetration in only two of the 11 Japanese industries officially designated as depressed under the old law from 1978 to 1983³⁾.

The Japanese government denies these charges, saying that its policy is not to protect depressed industries from imports but to promote their adjustment to structural change by encouraging capacity reduction and other revitalization efforts. Japan says that imports are taken into account in the medium-term supply/demand projections. Japan also says that imports are in fact increasing in most of these industries, and in related industries, even though foreign goods sometimes suffer from relatively weak competitiveness in non-price factors such as quality, reliability of supply, and suitability to the Japanese market.

Import Trends

In evaluating this issue, TSG has found merit in the positions of both sides. Our analysis is based primarily on data for the 11 industries designated under the old restructuring law from 1978 to 1983. They furnish concrete examples of Japanese government policy for depressed industries, and also allow measurement of trends over a number of years.

There is no debate about price competitiveness. It is well known that import prices of basic materials are in most cases lower than those of the same materials produced in Japan. For example, the average price of imported urea in 1982 was ¥43,447 per metric ton CIF — 22% less than the ¥56,047 average price of domestic urea. Imported aluminum ingot cost ¥327,020 per metric ton in 1982 compared to ¥496,490 for domestic ingots, a differential of 34%.

Trade statistics also tend to support U.S. contentions. In most of Japan's designated depressed industries, import penetration is well below the level that seems warranted by the price competitiveness of the foreign goods involved. Only in aluminum and ferrosilicon — the two exceptions noted by the United States — have imports increased to high levels. The recent claim of one Japanese official that aluminum is a "representative example" of depressed industry imports is not supported by the facts. As shown in Table 1, import penetration is less than 7% of the Japanese market in nine of the 11 industries designated under the old law.⁴⁾ In four of these industries the import share has decreased, and in two others

Table 1: **Import Penetration in Japan's Designated Depressed Industries**
(total imports as share of Japanese consumption)

	1978	1979	1980	1981	1982	1983
Electric Furnace Steel	*	*	*	*	*	*
Ferrosilicon	31.0%	27.0%	32.0%	48.0%	57.0%	65.0%
Aluminum	44.0	37.0	57.0	66.0	81.0	83.0
Container Board	2.5	2.6	4.8	5.9	4.8	5.0
Urea	0.3	0.3	0.5	1.2	3.4	6.4
Ammonia	*	*	*	*	*	*
Wet-Process Phosphoric Acid**	7.9	9.4	9.4	7.2	6.6	n/a
Polyacrylonitrile Staple Fiber	7.6	12.8	4.8	4.0	3.3	2.4
Polyester Staple Fiber	7.1	5.0	3.4	1.4	2.0	4.3
Nylon Filament	1.6	2.3	3.0	3.8	2.9	2.9
Polyester Filament	5.7	3.1	5.5	6.1	4.8	4.2
***Paper (kraft liner)	7.4	7.7	14.1	16.4	13.6	15.5
***Ethylene	*	*	*	*	2.1	3.1

Source: MITI *less than 0.1%

**figures are for 12-month period beginning in July of each year

***designated under new law

³⁾ Originally, 14 industries were designated. Two spinning industries were subsequently administered under a different law, and the restructuring plan for shipbuilding was successfully completed by 1980.

⁴⁾ Unless otherwise noted, all import data in this chapter refer to total imports, from all sources worldwide.

imports remain negligible. These trends contrast with the high import penetration in U.S. industries that have declined in competitiveness, even in those where import restraints have been imposed, such as automobiles (26% of the U.S. market in 1983), steel (20.5%), and motorcycles (91%).

Nevertheless, it is true that in most of Japan's depressed industries imports have been increasing. Import penetration reached 83% for aluminum and 65% for ferrosilicon in 1983. Although the figures are much lower for the other industries in question, between 1978 and 1983 imports increased their market share from 2.5% to 5% for container board, from 0.3% to 6.4% for urea, and from 1.6% to 2.9% for nylon filament.

Two other depressed industries of concern to the U.S. — paper and ethylene — were recently designated under the new law. Import penetration remains low in both cases but has increased since 1978, from 7.4% to 15.5% for kraft liner paper, and from negligible amounts to 3.1% for ethylene.

Japan says it is not sufficient to look only at the designated depressed industries. In the case of ethylene, for example, imports of one of its major derivatives, ethylene glycol, have risen sharply during the same period: from 5.6% of the Japanese market in 1978 to 32.4% in 1983. Imports of acrylonitrile, which is made from a co-product of ethylene, have increased from a 0.6% market share to 21.4%. These related products are physically much easier than ethylene to ship overseas. Their imports have contributed to the decline in demand for domestic ethylene. Earlier this year, two Japanese petrochemical manufacturers opted to meet supply shortages by purchasing ethylene abroad rather than resuming production at domestic facilities that have been shut down under the new restructuring law.

The case of wet-process phosphoric acid is similar. Imports of this chemical have remained low, due considerably to the difficulty in transporting it. But its main use is as a raw material for the fertilizer ammonium phosphate, and from 1978 to 1983 import penetration of ammonium phosphate increased from 30% to 54%, thus reducing the demand for phosphoric acid.

The high import penetration in aluminum, ferrosilicon, ethylene-related products, and ammonium phosphate, and the smaller but measurable increases in several other industries, indicate that restructuring is progressing in Japan. Other important evidence of adjustment is the shift of production to overseas sites where costs are lower. Representative examples include a Japanese consortium's new aluminum smelting plant in Indonesia, the Mitsubishi Group's petrochemical complex in Saudi Arabia, and investments by Jujo Paper Co. in joint-venture mills with Weyerhaeuser Co. in the United States. Most of these overseas operations export some of their output of Japan.

Government Policies

Although adjustment is occurring, the fact that import penetration remains low in most designated depressed industries is cited by the United States as important evidence of Japanese protectionism. As mentioned above, the Japanese government denies that it pursues protectionist policies, attributing the low level of imports instead to inadequate sales efforts by foreign suppliers and other commercial factors. U.S. officials acknowledge a lack of aggressive marketing by some potential U.S. exporters, and this problem is discussed later in the chapter. But the United States insists that Japanese protectionism is the major reason for low import penetration. TSG believes this charge warrants careful evaluation from its independent, binational perspective.

Tariffs, though not the focus of the depressed industries debate, are clearly one form of protection for these industries. U.S. forest products firms, for example, have found that Japan's duties of 15% on plywood and 9.3% on kraft linerboard are significant obstacles to imports by Japan. (Some progress has been made on this issue with Japan's recent decision to reduce the linerboard tariff to 7% in three stages, beginning in April 1985.) U.S. aluminum manufacturers, meanwhile, believe that Japan's 12.2% tariff on aluminum sheet has been a major cause of the sharp decline in sheet imports during the past decade. As for steel, expected by many analysts to be a declining industry in the future, the Japanese government recently limited duty-free GSP treatment for two products that have shown a rapid increase in imports. While the total amount of steel that can be imported duty-free from developing countries will be increased sevenfold, a 4.9% tariff will be imposed on imports of hot-rolled steel coils and heavy and medium steel plates when they exceed ceilings based on 1982 import levels.⁵⁾ Japanese petrochemical manufacturers reportedly are now seeking discontinuation of similar preferential tariffs.

The restructuring law itself contains no provision for restricting imports. Furthermore, it makes government support contingent upon industry adjustment, including reduction of capacity. In these respects, as Japan correctly maintains, the law is consistent with the OECD's positive adjustment guidelines for industrial policy.⁶⁾ Nevertheless, the United States has raised important questions about how the law is

⁵⁾*New York Times*, March 20, 1984; *Japan Economic Journal*, April 24, 1984

⁶⁾The OECD guidelines state that assistance to specific industries should: (a) be temporary, (b) be linked to the phasing out of obsolete capacity, (c) be transparent, and (d) not include protection against imports.

applied.

One aspect of the law that conflicts with the OECD guidelines is the insufficient transparency in its implementation. To be sure, the poor understanding of Japanese policies is partly a matter of foreigners' insufficient knowledge of the Japanese language. MITI has published a guidebook (in Japanese) that explains the new law, and the Japanese press reports on the formulation of restructuring plans and their administration by MITI. American businessmen should make greater efforts to tap these published sources and to communicate directly with the Ministry. But despite the availability of such information, the fact remains that Japan's policy-making itself is rarely conducted in public view. Many key decisions are made in private discussions between Japanese businessmen and government officials.

In an attempt to overcome the transparency problem in Japan, the United States is seeking to participate in MITI's Industrial Structure Council, where restructuring plans are formulated. MITI has responded that a mechanism for such participation already exists: foreigners can appear as expert witnesses, when the Chairman of the Council decides to invite them.

TSG is encouraged by MITI's position, but we feel it is only a first step. TSG hopes that MITI will make an actual commitment to invite foreigners to Council meetings, and on a regular basis. TSG also urges the Council to explain its own views and decisions more openly. It is essential that Japan's trading partners be given clear explanations of policies that affect their commercial interests, as well as the opportunity to express their views to Japanese policy-makers.

TSG believes that the Japanese system should seek to

achieve the same degree of transparency as that of the United States, where policy issues are widely and openly discussed in a variety of public forums, including frequent public hearings of regulatory agencies and Congressional committees. Foreigners are encouraged to take part in this process, and Japanese spokesmen participate regularly and actively. It is equally important for Americans to make their best effort to learn about Japanese policies.

TSG emphasizes the need for greater transparency because it emerges as a matter of great concern in a number of trade-related areas, not in the depressed industries debate alone. TSG is not suggesting that Japan should change its policy-making system. But the system should function in a more open and public way. Only by taking more initiative to communicate its thinking and intentions to its trading partners and engaging in open dialogue with them well in advance of final policy decisions can Japan remove foreign suspicions about quiet understandings that may be intended to restrict imports. We hope that the Chairman of the Industrial Structure Council, with MITI's support, will exercise his discretionary authority as positively as possible so as to make MITI a model for other Japanese government agencies in transparency of administration.

The United States has also questioned the effectiveness of the restructuring law in promoting genuine restructuring. A key objective of the law is to eliminate excess capacity. Yet except for aluminum and ferrosilicon, even the smaller 1988 capacities targeted for Japan's depressed industries remain well above the levels of current domestic demand — although demand has been stable or declining in recent years. This is shown in Table 2.

Table 2: Capacity-Scrapping Plans

	1988 Target	1983 Consumption	1983 Production
Ferrosilicon	307,000	454,883	182,111
Aluminum	702,000	1,536,033	253,543
Urea	1,476,000	867,760	980,000
Ammonia	2,640,000	1,879,705	1,881,000
Fused Magnesium Phosphate	510,000	385,699	351,119
PVC Resin	1,552,000	1,408,657	1,420,396
Polyacrylonitrile Staple	394,000*	249,793	355,202
Polyester Staple	349,000	224,356	319,773
Nylon Filament	321,000	236,023	271,140
Polyester Filament	411,000	279,743	310,041
Ethylene	4,071,000	3,797,410	3,687,690

Source: capacity targets calculated from figures in *Japan Economic Journal*, October 18, 1983; consumption data from official Japanese government and trade association figures, as provided by U.S. Embassy

*capacity target already reached

To the United States, the high capacity targets suggest that MITI is still pursuing Japan's traditional policy of self-sufficiency. This conclusion does not necessarily follow. For one thing, capacity levels must be somewhat higher than domestic demand in order to permit optimum utilization and, in some cases, to meet export demand. Furthermore, as noted by Japanese businessmen, the unrealistically high targets reflect the need to achieve consensus for restructuring plans among producers who are reluctant to reduce capacity. Japanese businessmen also maintain that the targets hardly serve as guarantees that the capacity will be fully utilized, that market forces rather than government plans determine actual capacity use. This contention is borne out by the facts: of eleven industries checked by TSG, the current production levels of six are significantly below the optimum 80-90% utilization rate when measured against the 1988 capacity targets. But even if we grant these points to Japan, there is still some basis for U.S. concern.

The reluctance of individual producers to reduce capacity is clear evidence of resistance to MITI's efforts to rationalize declining industries. According to a recent Hudson Institute study, this resistance will become stronger as the industries involved continue to lose competitiveness, thus increasing domestic pressure for protectionism during the coming decade.⁷⁾ The recent moves toward restricting preferential tariff treatment for steel and petrochemical products are further evidence of this pressure. As long as substantial excess capacity exists, it is a potential breeding ground for protectionist pressures. This is true in any country.

The United States has inferred some evidence of protectionism from the administration of the capacity-scraping activities that are a main element of Japan's industrial restructuring plans. Whether a plan is based on a government-instructed cartel or individual corporate actions, its effectiveness requires a substantial number of firms in the industry to reduce their capacities, often by significant amounts. In two cases known to the TSG, an electric furnace steel maker and 22 cardboard paper manufacturers refused to participate in restructuring plans and were thus able to increase their market shares at the expense of the participating firms. These may be exceptional cases, but they suggest that overseas companies, not being in the restructuring plans, should likewise find good opportunities to increase their share of the Japanese market.

The key question in dispute is why these opportunities have not been realized to any significant extent. One reason,

as noted above, is insufficient export efforts by some American businessmen. This problem, together with Japanese business practices, is discussed in the following section. With respect to government policies, U.S. officials do not contend that the restructuring law directly restricts imports, but they do say that industries agree to participate in capacity-scraping plans under the law in return for administrative guidance by MITI to limit the inroads made by foreign goods. The U.S. and Japanese sides of TSG have differing views on this point.

The most recent evidence of such import restraint cited by the United States concerns chemical fertilizers. Ammonia and urea are both designated for the scrapping of capacity under the restructuring law; in addition, urea has long been regulated by the Fertilizer Price Stabilization Law. The latter law, which is intended to secure stable domestic supplies of fertilizer at reasonable prices for food production, has resulted in prices at above world market levels. According to recent Japanese press reports, MITI and the Ministry of Agriculture, Forestry and Fisheries have given the domestic fertilizer industry further support by holding private talks with Zenno (the National Federation of Agricultural Cooperative Associations), and influencing it to limit its imports of fertilizer. Zenno controls 70% of chemical fertilizer sales in Japan. Some Japanese farmers have begun to protest that the lack of free access to imports, together with the price stabilization system, forces up the price they must pay for fertilizer.⁸⁾

Another reported example of MITI guidance was the response in 1981 to demands by the ferroalloy industry for protection against surging imports. MITI's response was to promote cost-reduction measures and to encourage a shift to overseas production, but at the same time the Director of MITI's Iron and Steel Production Division sent letters to all Japanese specialty steel makers asking them to give special consideration to buying domestic ferrochrome.⁹⁾ Despite this guidance, imports increased from 190,000 tons in 1981 to 298,000 tons in 1983.

A somewhat different case was the illegal cartel established by four Japanese producers to limit imports of soda ash. This chemical is not produced by an officially-designated depressed industry, but it is a basic material that is not price-competitive with imports. U.S. government and business sources say that MITI supported the soda ash import cartel through administrative guidance, although MITI denies involvement. In response to information provided by U.S. exporters and overtures by the U.S. government, Japan's Fair Trade Commission investigated and found the cartel to be in

⁷⁾Wheeler, J., M. Janow, and T. Pepper, *Japanese Industrial Development Policies in the 1980's: Implications for U.S. Trade and Investment*. New York: Hudson Institute, October 1982

⁸⁾*Asahi Shimbun*, January 11, 1984; February 8, 1984

⁹⁾*Tekko Shimbun*, June 26, 1981

violation of the Antimonopoly Act. Following the dissolution of the cartel in 1983 and price reductions by U.S. exporters, imports of soda ash from the United States increased nearly fivefold over 1982 and are expected to rise another 40% this year. Japanese producers are now reportedly trying to check this import surge by pressuring users and distributors to limit purchases from U.S. suppliers. The U.S. government suspects that an import cartel has been re-established, and in response to its request the Fair Trade Commission has initiated a follow-up investigation of this matter.¹⁰⁾

U.S. officials report preliminary evidence of similar collusion in other depressed industries. In petrochemicals, the American Embassy in Tokyo has been told of agreements between Japanese producers and consumers to limit imports of several products, including some plastics. U.S. officials have also heard that the Japan Soda Industry Association has been pressuring users of caustic soda not to import. Although no evidence of Japanese government involvement has yet been found in either case, the United States suspects administrative guidance because the Japanese government works closely with the respective industry associations.

These latter, unsubstantiated charges are mentioned for two reasons. One is their plausibility. They are similar to the case actually documented by the Fair Trade Commission and to those reported in the Japanese press, and they conform to the pattern of administrative guidance and closely intermeshing business relationships that are well known to those having first-hand experience in Japan.

The other reason for citing such charges is that they typify the problems involved in proving complaints of Japanese protectionism. The case for the existence of protectionism — as government policy — in Japan's depressed industries rests ultimately on whether or not there is evidence of administrative guidance to that end. TSG has identified no other mechanism by which the Japanese government may be restricting imports in these industries. The inadequate transparency of policy-making under the restructuring law may raise suspicions, as may the unrealistically high capacity levels maintained under the law, but neither constitutes proof of protectionism. Nor has TSG found evidence that capacity reductions under the law have been linked to MITI-guided import limitations as a *quid pro quo*. Administrative guidance itself is certainly a well-known and important feature of the Japanese governmental system. But by its nature, this guidance is informal. It is based on the close personal connections and traditional spirit of cooperation between Japan's public and private sectors. Actual instances of such guidance are rarely disclosed and difficult to document.

Because of these characteristics of administrative guidance, TSG has been unable to reach a consensus on whether

it has been used for protectionist purposes. The American side believes that the Japanese government has used administrative guidance to limit imports. The Japanese side does not believe the government has done so. There is agreement on one conclusion: that, pending more concrete evidence, much of the U.S. case for the existence of official protectionism in Japan's depressed industries is unproven.

The U.S. case is also inconsistent with the existence of protectionism in some American policies and attitudes. Most obvious is the fact that the U.S. provides import protection for its depressed industries, such as steel, autos, and textiles. U.S. officials note that import penetration is high in these industries — much higher than in most Japanese depressed industries — but the fact remains that the United States does take protectionist actions. Moreover, it does so without requiring adjustment measures by the protected industries. Failure to require adjustment often results in prolonging the depressed conditions which lead to protection in the first place.

TSG also questions several complaints the U.S. has made in connection with the overseas investments by some of Japan's depressed industries. The U.S. claims that exports from some new foreign-based Japanese petrochemical plants are being unfairly diverted to the U.S. and other countries as a result of protectionism in the Japanese market; that Japanese aluminum smelters overseas are given an unfair advantage in shipping ingots to Japan because of discriminatory two-year tariff exemptions given to them by the Japanese government; that it is inappropriate for the Japanese government to provide credits to finance new steel plants in developing countries at a time of world over-capacity. TSG certainly opposes any such measures if Japan is taking them unfairly or in violation of international agreements. But in our view it is important to acknowledge that the shifting of capacity from Japan to overseas locations is part of the process of positive structural change. Such adjustment should be applauded. Whether rightly or not, the U.S. complaints raise the suspicion that their real purpose is to minimize the threat of stronger competitive pressures against U.S. firms.

The United States must also concede that its price advantages in many depressed industries are partly a result of U.S. price controls on natural gas, the raw material for several of these industries. Japan also makes the point that U.S. tariff rates on some depressed-industry products are higher than comparable Japanese duties.

Business Practices

In addition to questions of government policy, the U.S. case against Japanese protectionism also includes charges against the business practices of Japanese firms. Here, too,

¹⁰⁾Japan Economic Journal, June 19, 1984

the evidence is mixed. One problem is that the United States sometimes fails to distinguish carefully between legal and illegal actions, or between strictly private corporate activities and those that are influenced by the government. U.S. businessmen frequently cite cases of Japanese firms refusing to buy foreign goods simply because of their origin, or unreasonably denying use of their loading or storage facilities to imports. Such actions are indeed wrong if they are taken jointly with other firms, involve other violations of Japanese law, or follow government direction or guidance in violation of international trade agreements. Otherwise, such actions must be conceded to be no more than competitive business practice and cannot be said to restrain trade unfairly.

More questionable is the practice of Japanese manufacturers who pressure customers or trading companies not to buy competing imports. This pressure is usually in the form of a threat that the manufacturer will suspend future supplies. Japanese businessmen acknowledge that such pressure is fairly commonly applied by Japanese firms, but they say that U.S. suppliers sometimes use similar tactics in the Japanese market. Americans believe that such pressure by Japanese firms is effective in restricting import sales in the Japanese market. American legal authorities tell TSG that this practice may violate sections 3 and 19 of Japan's Antimonopoly Act, and that its prevalence therefore warrants stronger enforcement of the Act by the Fair Trade Commission.¹¹⁾ The Japanese view is different. Businessmen say that the standard normally used in determining the existence of monopolistic practices is whether effective competition exists in the market. A legal expert says that control by the guilty party of a substantial share of the market usually must be present for alleged monopolistic practices to be judged violations of the Act.

TSG does not suggest that all Japanese firms take such an aggressive approach to business. They frequently have more benign reasons not to buy imports. One reason is cultural: a Japanese preference for stable, long-term business relationships with well-known customers and suppliers. This preference often makes Japanese reluctant to abandon traditional suppliers for new suppliers. This obstacle also faces new Japanese firms seeking to enter established markets, but it is a greater problem for foreign suppliers who lack familiarity with Japanese language and customs. A related factor is Japanese concern about reliability of supply. With limited food resources and virtually no energy and mineral resources, Japan is a vulnerable nation that feels more secure if it can produce its basic materials at home.

Equally important business obstacles to export expansion lie on the U.S. side. For example, many U.S. firms are unwilling to make the long-term commitment necessary to sell in Japan. In one typical case, a U.S. company exported a petrochemical product to Japan during a two-year period of oversupply in the U.S. market, but thereafter it was content to sell only in the United States. In a somewhat different case, a U.S. chemical supplier raised prices substantially after the Japanese customers had re-tooled their plants to use the imported products. Another common complaint of Japanese buyers is the unwillingness of some U.S. producers to meet Japanese quality requirements, which are considered especially important in basic materials because of their wide use in manufacturing a variety of products. Japanese buyers also say that some U.S. exporters are reluctant to modify their products to suit Japanese market needs. Some fertilizer producers, for example, will not package their product in small bags — a necessity for Japan due to the small size of most farms. Still another Japanese concern is that many U.S. suppliers do not provide adequate after-sales services to their customers.

When a U.S. firm does make a commitment to the Japanese market and adapts its products to that market, however, it can be quite successful. One example is Webco Lumber Inc., a small West Coast company that recovered from near-bankruptcy after deciding to export most of its lumber to Japan. Webco succeeded because of its willingness to retool its mills so as to produce to Japanese standards and specifications, and to make a long-term commitment to Japanese customers.

But as legitimate as these factors are, it appears that Japan sometimes exaggerates their importance in attempting to justify the low level of Japanese imports. Americans say that Japanese customers often regard foreigners as marginal suppliers, to be used only in times of domestic shortages. Even U.S. firms that have been steady suppliers to Japan for many years complain that they are still questioned about their reliability. They add that such questions are often employed as negotiating tactics to bargain for lower prices. In the case of fertilizer packaging noted above, the U.S. Embassy in Tokyo says it has studied this matter and found that importing fertilizer in bulk and bagging it in Japan would increase the price only marginally and still leave the U.S. product very competitive.

There is a more fundamental reason for having reservations about Japan's emphasis on reliability of supply. Indeed, it is difficult to escape the suspicion that the issue of reliable supply is sometimes an excuse for protecting domestic pro-

¹¹⁾Section 3 prohibits actions by one or more firms to exclude or control the business activities of competitors. Section 19 prohibits unfair trade practices, including efforts to coerce another party not to deal with a competitor.

duction and jobs. Japan's depressed industries are largely dependent on imports for their raw materials. Petrochemicals, fertilizers, and synthetic fibers depend on imported petroleum. Aluminum smelting depends on imported bauxite and electricity generated from imported petroleum. Paper products depend to some extent on imported logs and wood chips. These industries are inherently vulnerable to any disruption of supply of the necessary raw materials. Yet Japan has succeeded in obtaining secure overseas supplies of the raw materials. It is reasonable to believe, therefore, that Japan could also find secure foreign supplies of the manufactured products.

Key Findings and Conclusions

1) Although Japan's industrial restructuring law contains no provision for restricting imports, the United States has made a circumstantial case for the existence of protectionism in depressed industries on the basis of these facts: imports are still at low levels despite uncompetitive domestic prices and the reduction of domestic production capacities; capacities are being maintained at levels higher than current domestic consumption; and Japan's process of policy-making lacks sufficient transparency.

2) The United States has provided more direct evidence of administrative guidance by the Japanese government to limit imports, but this evidence is not conclusive. The American side of TSG finds the evidence persuasive; the Japanese side does not.

3) To the extent that official protectionism may exist, its impact may be simply to slow rather than prevent a rise in imports, because it seems apparent that adjustment is occurring in Japan's depressed industries. Production is being reduced or shifted to overseas locations, and imports are increasing.

4) U.S. criticism of Japanese protectionism is undermined to some extent by the protection given to depressed industries in the United States.

5) The strength of traditional business relationships in Japan can make it difficult for new firms — especially foreign companies — to enter the market.

6) Japanese concern about reliable supply is understandable to some extent, but it sometimes appears to be used as an excuse for not buying imports or as a means of negotiating a better deal.

7) In at least one proven case, Japanese firms formed an illegal cartel to limit imports. Other restrictive business practices in common use may also violate Japan's Antimonopoly Act, though Japanese concepts of antitrust enforcement seem to be somewhat different from those in the United States.

8) Otherwise, to the extent that they do not violate Japanese law or international trade agreements, Japanese corporate practices seem to be legitimate though at times aggressively competitive.

9) Many U.S. firms do not make a sufficient commitment to meeting the requirements of the Japanese market. Firms that do make the effort can often succeed.

Recommendations

To help solve the problems discussed above and to reduce trade friction related to Japan's depressed industries, TSG makes the following recommendations:

1) To increase the credibility of its attack on Japanese protectionism, the United States should make strong efforts to present more convincing evidence of import restrictions, whether initiated by government administrative guidance or by illegal corporate actions. Such efforts may become increasingly necessary, given the likelihood that protectionist pressures may intensify in Japan's depressed industries. In many cases, moreover, the resolution of disputes will require more concrete evidence than the United States has provided.

2) In the case of illegal private cartels and other restrictive business practices, the fight against protectionism should be supported by more vigorous enforcement of the Antimonopoly Act by Japan's Fair Trade Commission. At the same time, the United States should recognize that Japanese law permits certain concerted actions that contribute positively to industrial restructuring.

3) To ensure the credibility of its position on depressed industry issues, Japan should make its policy-making process as fully transparent as possible. MITI should find ways of receiving foreign views and of explaining its thinking and proposals openly and publicly, so that Japan's trading partners will have a clear understanding of how industrial restructuring plans are formulated and administered. In addition, U.S. officials and businessmen should make greater efforts to read or translate the information already available in Japanese about restructuring plans.

4) In the event that much excess capacity will remain in several depressed industries even after the current restructuring plans are completed, Japan should adopt further adjustment measures in order to minimize future protectionist demands.

5) To reduce suspicions about Japan's motives and intentions, administrative guidance by MITI and other government agencies should be transparent to the maximum possible extent. Such guidance should never be used to restrict imports.

6) The United States should acknowledge the positive adjustment that is taking place in Japan's depressed indus-

tries. The United States should also resist more strongly the calls to protect its own depressed industries. If protectionist measures are taken, they should be in compliance with international trade agreements (under GATT safeguard provisions, for example), and they should be accompanied by strict requirements that the industry in question take adjustment measures.

7) The United States should also recognize that many alleged Japanese trade barriers are really unintended obstacles that are rooted in traditional Japanese culture and ways of doing business. The political fight against protectionism should focus on deliberate official barriers and illegal business practices. Problems that derive from Japanese culture can only be overcome by the patient effort of U.S. business.

8) The dispute over reliability of supply can only be solved by a change in attitude on both sides. More American businessmen must be willing to make long-term commitments to the Japanese market and to adapt their products when necessary. More Japanese must acknowledge that they can secure reliable supplies of goods from overseas sources and that their fears in this regard are, to a considerable extent, obsolete.

9) American businessmen should investigate opportunities to invest in Japan's depressed industries. This possibility has been suggested by U.S. officials, and may offer another way for U.S. firms to increase their access to the

Japanese market. Investment in actual production is not a viable option, given high Japanese energy and raw material costs that led these industries into depression. But it may be feasible for U.S. firms to make acquisitions or direct investment in marketing and distribution facilities to promote the sale of imports. Another possibility might be advanced processing of depressed-industry products, such as aluminum fabrication, in cases where U.S. companies have superior technology and could produce at lower cost than Japanese firms. When appropriate, the Japanese government should assist U.S. companies in pursuing such investment.

10) To contain the global spread of protectionism stemming from the difficulties of industrial adjustment in many countries, the U.S. and Japanese governments should consider taking initiatives to make the adjustment issue an agenda item at multilateral trade negotiations. One possible objective might be to define internationally acceptable industrial policy measures. Another might be to establish an international body to collect and analyze global supply-and-demand data for depressed industries, especially those having excess capacity worldwide. The OECD Steel Committee is a precedent for such an approach.

11) TSG has not investigated how the problem of job dislocations is addressed in Japan's industrial restructuring policies and practices, but we believe that this subject merits study in the future.

Chapter 8

INVESTMENT POLICY

Since its start in 1977, TSG has focused primarily on the need to increase exports of U.S. goods and services to Japan. Such exports are, of course, only one aspect of the economic relationship between the two countries. They have tended to overshadow other aspects of that relationship, however, because of the large deficits the United States has recorded in recent years in its merchandise trade with Japan.

Direct investment by U.S. firms in manufacturing and marketing facilities in Japan also plays a significant role in the U.S.-Japan relationship. During the fiscal year ended March 31, 1984, new foreign direct investment in Japan totaled \$813 million, of which the U.S. share was \$432 million (53%). The cumulative amount of such investment in Japan as of the same date was \$4,973 million, and the U.S. share was \$2,441 million (49%).

There is considerable evidence that access to markets that are difficult to penetrate through imports can often be gained through local manufacturing, especially if the manufacturer is at least partially owned by the overseas firm seeking to enter the market. In addition, local manufacturing can serve to protect or enhance the position of imported products that have already established a foothold in the market. These principles were documented, in the case of U.S. companies in the Japanese market, in A.T. Kearney & Co.'s study *U.S. Manufacturing Investment in Japan*, prepared in 1979 for the American Chamber of Commerce in Japan. The Kearney study also revealed that local manufacturing stimulated additional exports from the United States of related goods and services.

Even where goods are produced in Japan by affiliates of U.S. firms for export to the United States, such production is often a response to a threatened loss of U.S. market share to more efficient foreign competition. In such case, Japanese production can actually help maintain the viability of U.S. firms in their home market. Some of the recent investments made by Japanese firms in the United States reflect a concern that their U.S. market share may not be sustainable in the future without similar local investment. There is growing recognition, therefore, that a liberal investment policy, in both the United States and Japan, is as important to the continued economic well-being of the two countries as is a liberal trade policy.

Japanese Investment Policy

Present Japanese policy with respect to foreign direct investment is embodied in legislation enacted in 1979 which repealed Japan's Foreign Investment Law and revised its Foreign Exchange and Foreign Trade Control Law to incorporate the controls on inward direct investment which the government decided should be retained after the Foreign Investment Law's repeal. Under the revised Law, a foreign direct investment in Japan must be reported to the government 15 days in advance. The government retains the power to block the investment for various reasons specified in the revised Law, but this power has not been used in the four years that the revised Law has been in effect.

Restrictions on foreign direct investment also exist under industry-specific laws such as those concerning broadcasting, telecommunications, electric power generation, and domestic rail and air transportation. This is comparable to the situation in the United States, and Article VII of the Japan-U.S. Treaty of Friendship, Commerce and Navigation specifically excepts these industries from national treatment in investment.

The difference between the climates for foreign investment in Japan and the United States results, then, not from the explicit statutory restrictions on foreign investment referred to above, but from the fact that business is subject to closer government regulation in Japan than in the United States. Such regulation has had the effect of restricting foreign entry either completely or to a significant extent in a number of service industries, ranging from trucking, warehousing and stevedoring to auditing and underwriting.

Much of this regulation is conducted in private, through administrative guidance, under circumstances that provide little opportunity for the regulated investor to challenge, in a neutral forum, treatment that he perceives to be unfair or unreasonable. Some of this guidance is given after consultation with other companies in the investor's industry, with a view to maintaining an "orderly market" or preventing "excessive competition". Though few cases of this informal regulation have been adequately documented, there is a widespread perception that the practice tends to stabilize the relative positions of companies already present in the market.

This approach to regulation is one of the major differences between U.S. and Japanese economic policy. It is likely to be a continuing source of friction between the two countries and will be difficult to deal with, since it may be argued with some justification that a country is entitled as a matter of national sovereignty to follow its own regulatory approach. The end result, however, is that Japanese companies enjoy relative freedom to enter most sectors of the U.S. market, through acquisitions (friendly or hostile) as well as green-field investment, while U.S. companies seeking to enter the Japanese market are often subject to guidance that may severely retard entry.

At the same time, there is growing recognition that new foreign investment is, in general, being promoted by both the national government and by prefectural and local governments, in recognition of the need to ease trade friction and because of self-interest in expanding the employment base in Japan. In the past several years, several programs have been introduced or expanded to facilitate additional investment by foreigners. To this end, government-supported financing has been made available to Japanese branches and subsidiaries of foreign companies, and a variety of other incentives that were already available but not well-known to the foreign business community have been more clearly pointed out to potential investors. Government authorities have held investment seminars in Japan and overseas, individual prefectures have organized industrial site inspection tours, and new foreign-language publications have been issued that describe investment opportunities in detail.

Most recently, the fifth round of market-opening measures, announced by the government in April 1984, contained several specific measures for promoting additional investment in Japan, including expansion of the authority of the Office of Trade Ombudsman to deal with investment problems. Also, the Office for the Promotion of Foreign Investment in Japan has been established within the Ministry of International Trade and Industry to provide information, guidance and consultation to foreign direct investors.

The full significance of these programs is not yet clear. It is unlikely that they will have a significant effect on the ability of foreign firms to acquire substantial equity interests in established Japanese firms. Existing patterns of interlocking stock ownership make such acquisitions extremely difficult. Moreover, other subtle factors inherent in the relationships between management and employees, suppliers and customers, and lenders and corporate borrowers, are obstacles to foreign takeovers that will limit the opportunities for market penetration through this approach. On the other hand, the incentive programs are clearly a positive step and should be expanded as much as possible.

It is likely that new U.S. investment in Japan will be concentrated, for the foreseeable future, in sectors of the economy that are dynamic and growing and in which, there-

fore, industry opposition to new market entrants will be at a minimum. These are also likely to be the most attractive areas for new-to-market investors. Good opportunities for expansion of existing U.S. investment may also arise, however, in mature or declining industries, as well as in politically sensitive sectors of the economy. These are areas in which there is a greater likelihood that existing firms may attempt to bring pressure on the government to restrict new market entrants. It is hoped that the government will resist such pressures and refrain from exercising control over these industries in ways which foreclose or limit foreign investment.

Allowing foreign law firms to open offices in Japan would also be helpful. Such firms can provide substantial assistance to foreign investors seeking to enter the Japanese market. To perform this function, however, foreign law firms must be permitted to form partnerships with and to hire Japanese *bengoshi* (practicing lawyers), so that they can, as firms, provide comprehensive legal services covering both Japanese and foreign legal aspects of an investment problem.

U.S. Investment Policy

The United States has historically followed a policy of almost complete freedom of entry for foreign investment. This policy was reaffirmed in a statement by the President of the United States on September 9, 1983, which expressly "welcome(d) foreign direct investment in this country." (The statement also expressed clear support for U.S. investment abroad.)

In contrast to Japan, the United States has not had a comprehensive notification or approval system governing foreign exchange and foreign investment, with the result that both inward and outward capital flows have been essentially unregulated since the end of World War II. The United States does restrict foreign investment under industry-specific laws such as those concerning inland shipping; broadcasting and telecommunications; domestic air transport; atomic energy; and mining on government lands. However, unlike Japan, the United States does not restrict foreign investment in agriculture, forestry and fisheries; petroleum exploration, production, refining and marketing; leather and leather products manufacturing; or trucking, warehousing and other service industries mentioned above.

U.S. regulation of industry has, in general, been relatively transparent, as a result of laws requiring that government agencies act in accordance with clearly-defined administrative procedures. These procedures are intended to insure objectivity and to provide a public and impartial adjudication of grievances by firms subject to the regulation. As in Japan, however, the reality has sometimes lagged behind the theory. In recent years, in particular, there has been growing perception in Japan that the United States is moving in the direction of less transparency and more discre-

tion in its policies toward regulating foreign competition.

This perception may be based, to some extent, on a lack of understanding of the distinction between legislation, which is inherently discretionary and subjective in nature, and regulation, which is required to be based on objective standards and is subject to challenge in the courts if it is exercised arbitrarily. But it also reflects a growing belief that the United States is becoming more protectionist and thus less liberal in its treatment of foreign businesses seeking to compete in the U.S. market.

Japanese businesses in the United States have expressed concern about the need to deal with conflicting regulations of different regulatory authorities having jurisdiction over their activities. While there are also multiple levels of regulation in Japan, the types of conflicts that can arise under the federal

system of government in the United States may be unique to that country. The adoption by a few states of the worldwide combined unitary apportionment method of taxing multinational corporations represents perhaps the most serious problem of this kind to have arisen in recent years.

The impact of state-imposed restrictions on investment in the United States is serious but should not be overestimated. Competition among states for new foreign investment limits the extent to which any one state will wish to follow a policy that discriminates against foreign investors. Moreover, state regulation is ultimately subject to Constitutional limits of due process and, in certain exceptional cases, to federal preemption. TSG believes that the unitary tax problem is a case in which such preemption would be appropriate.



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